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# Financial Globalization and Regulation

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## 1. INTRODUCTION[1]

The term financial globalization refers to the process by which financial markets of various countries of the globe are integrated as one. Financial globalization may also be defined as a free movement of finance across national boundaries without facing any restrictions. We argue that financial liberalization is not alone sufficient condition for financial globalization. Financial globalization requires the introduction of a worldwide single currency managed and regulated by a single international monetary authority. The first age of unregulated financial globalization, 1870s to 1913, when London arguably acted as the center of financial activity, was a period that can be categorized as the early stage of development of international financial institutions and markets (Eichengreen and Bordo 2002). That period was marred by a series of banking crises due to speculation, excessive lending, poorly managed funds, ill regulated banking systems and non-disclosure of information. Interestingly enough, Keynes (1971) depicted the 1870-1913 financial globalization in these terms: "The inhabitant of London could order by telephone ….. the various products of the whole earth …..adventure his wealth in the natural resources of any quarter of the world, and share ….. in their prospective fruits and advantages ….. couple the security of his fortunes with ….. any substantial municipality in any continent that fancy or information might recommend ….. secure forthwith ….. cheap and comfortable means of transit to any country ….. supply of precious metals as might seem convenient, and could then proceed abroad to foreign quarters ….. bearing coined wealth" (p. 6-7).

The history of international financial sector development in the inter-war period, 1919 to 1939, was not a particularly happy one either; in fact it was deeply scarred by the stock market collapse in the late 1920s, followed by the Great Depression. The post World-War II period was characterized by a number of financial controls and fixed exchange rates, at least until up to the early 1970s. Banking crises were absent during the period from 1945 to the early 1970s, although currency crises were in evidence (for example, the 1949 and 1963 sterling pound crises that led to the devaluation of the currency). From then onwards the

[1] This paper draws and extends our previously published paper on the same theme (Arestis and Basu 2003).

process of financial liberalization began, and banking crises re-emerged in a new era of broadly flexible exchange rates, which brought a free movement of capital. It is this period that it is thought to be the latest era of financial globalization. It is, of course, the case that the degree of financial globalization achieved in 1870-1913 was only achieved again in the 1990s (Prasad et al, 2003, p. 60).

This paper seeks to examine the required condition for the emergence of the current epoch of financial globalization. We argue that this condition is the regulation of financially globalized markets. We proceed in section 2 where we examine financial globalization as a process of deregulation. The requirements if financial globalization are examined in section 3, before we discuss the problems of financial globalization in section 4. Financial regulation and financial globalization are closely scrutinized in section 5. Finally, section 6 summarizes the argument and concludes.

## 2. FINANCIAL GLOBALIZATION AS A PROCESS OF DEREGULATION

The detrimental aspect of unregulated financial integration following the experience of the Great Depression was recognized by many countries across the World.[2] Accordingly, not only developed, but also newly-formed, countries undertook various measures in order to prevent financial instability. It was recognized that to prevent the latter, there was a need to control financial flows that were purely speculative in nature, and to ensure that possible expansion in aggregate expenditure in the productive aspect of the economy was not constrained by inadequacies in the financial flow. Consequently, regulations within national boundaries took the form of preventing financial flows that were mainly geared for speculative activity. The specificity of the regulations may have differed from country to country but the aim of those regulations was to ensure that credit would be allocated to industry and trade (Sayers 1960, Basu 2002).

[2] The terms "financial globalization" and "financial integration" need some clarification. We follow Prasad et al (2003) in defining and distinguishing between these terms: "Financial globalization is an aggregate concept that refers to rising global linkages through cross-border financial flows. Financial integration refers to an individual country's linkages to international capital markets. Clearly, these concepts are closely related. For instance, increasing financial globalization is perforce associated with rising financial integration on average" (p. 7). We follow this terminology and distinction between these terms in this study.

In addition to those regulations almost every country made further provisions to ensure that the productive sectors were neither constrained by the price of finance nor by inadequate financial flows. This often arose either as a result of lenders' inadequate knowledge about a particular sector, or as a result of borrowers' inability to meet lenders' *credit standards*. This can be explained by referring to the fact that financial markets operate in the presence of uncertainty, and lenders ask for collateral or some form of security in order to ensure that should borrowers default on loans, some alternative means exist to enable lenders to recoup their loan capital. This is precisely what we have just referred to as *credit standard* (see, also, Basu 2002).[3] As a result, the ceiling on interest rates was introduced in order to ensure that borrowers were not constrained by the price, and specialized banks were developed to ensure that the lenders' lack of knowledge did not prevent the financial flows to specific sectors. Furthermore, in certain countries the government stood as guarantor, and in other countries banks were instructed to reduce the credit standard requirements. That was aimed at ensuring that certain groups of borrowers were not constrained by interruptions to the financial flows that arose from their inability to meet banks' credit standard requirements.

At the international level, a variety of controls were established in order to ensure that the foreign financial flows were mainly concentrated on the productive aspect of the economy. In order to prevent a free financial flow and exit, those controls also embraced the purchase of foreign currency. In some instances, governments stood as a direct guarantor between the foreign lenders and the domestic borrowers to ensure that the growth of local

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[3] This is very much reminiscent of the "new" consensus "collateral," which emerges when the assumption of frictionless financial markets is dropped; see, for example, Bernanke et al (1999). It is important to note that most authors do not distinguish between collateral that essentially constitutes equity finance and collateral that can meet the bank's credit standard. This problem principally arises from the fact that banks often themselves use equity finance as collateral when dealing with large borrowers, but would not accept equity finance as collateral when dealing with small borrowers. By equity finance we mean assets that are bought with the assistance of the loan. This form of collateral cannot protect a bank's principal. This is simply because debt repayment as well as recoupment of the principal will be tied up with the assets that are purchased with the assistance of the loan. The problem is if the return from the assets is not sufficient to meet the bank's repayment, then these assets' value is more likely to fall, thereby creating a problem for the banks to recoup the principal from the sale of these assets. As banks conveniently change their definition of collateral for different groups of borrowers, it became extremely difficult for the authors of the credit rationing literature not only to explain why banks ration credit but also how they ration credit. Subsequently, Stiglitz and Weiss (1981) used price as the signalling device to explain why banks ration credit, where they use two assumptions namely the "adverse selection" and "incentive" effects, both of which assumptions deal with the psychological state of the borrowers. However Stiglitz and Weiss do not use collateral as a rationing device. See Basu (2002) for more on this issue.

industries was not constrained by inadequate foreign financial flows arising from their inability to meet the foreign lenders' credit standard requirements.

The main objective of those regulations was to bring financial stability and to promote governments' economic and social objectives. This was the case for developed as well as for developing countries. An important implication of those regulations was to undermine the independence of the financial sector as a profit-seeking economic unit. A further implication was that, since banks were prohibited by regulation from advancing loans to certain areas of economic activity, the opportunity for new institutions to emerge, in order to capture that end of the loan market, arose. Banks' share of the loan market fell as a result, thereby affecting the effectiveness of the traditional tools that had been used by monetary authorities in the past to control the money stock at the national level (Basu 2002). This was mainly because those new institutions were not subject to the same regulations as the banks. Policies that were implemented in order to promote the access of smaller borrowers to the loan market at a cheaper rate, largely remained ineffective. They also adversely affected whatever limited access they may have had to the loan markets in the past. Some serious doubts were also raised, in particular about the merits of the ceiling on interest rates, as a vehicle to provide loans to these borrowers at a cheaper rate (Basu 1989).

The ineffectiveness of those interventions in terms of bringing allocational efficiency to the financial sector led one country after another to deregulate its financial sector. The view was taken that government intervention itself distorts the determination of the price of loans, thereby adversely affecting not only the allocation of loans but also savings. This view was originally put forward by McKinnon (1973) and Shaw (1973), and subsequently further developed by Fry (1995, 1997), King and Levine (1993a and 1993b) and others.[4] It was argued that in the absence of intervention, market forces would determine the rate of interest, which in turn would govern the allocation of loans. The presumption was that interest rate plays a crucial linking role between savings, investment and growth rates, and government

[4] See also Greenwood and Jovanovic (1990), Levine and Zervos (1996 and 1998), Rajan and Zingales (1998), Roubini and Sala-i-Martin (1992) and Saint-Paul (1992) who produce arguments along similar lines. However, a number of studies, such as Arestis and Demetriades (1997), Arestis, Demetriades and Fattouh (2003) Basu (1994 and 2002), Diaz-Alecjandro (1985), Morisset (1993) and Singh (1997), who point out that the propositions and results derived by the supporters of the financial liberalization thesis are neither empirically nor theoretically tenable.

intervention either distorts or de-emphasizes the role of interest rate, thereby producing low savings and, thus, low growth rates.

## 2. REQUIREMENTS FOR FINANCIAL GLOBALIZATION

The crucial message of the financial liberalization thesis is that it is the lack of competition, which brings inefficiency to the financial sector. Interest rate liberalization is a first step, but it was recognized that this alone would not generate competition in this market, since this market operates within the frame of oligopolistic competition. Consequently, not only is there a need to increase the number of players in this market, but also to tap a larger pool of savings, which a country may be required to seek beyond its own domestic boundary. To increase the number of players there is a need to remove entry restrictions so that other banks and Non-Bank Financial Intermediaries (NBFI) as well as overseas banks can enter into this market. In order to tap a larger pool of savings, there is a need to remove controls over the purchase and sale of foreign currency. There is also need to relax laws relating to takeover and merger activities, and, consequently, the requirement arises to liberalize the external sector of the financial system.

A view thereby emerged, similar to that of the school of financial liberalization, that government intervention in the foreign exchange market to determine the price of currency, could cause a great deal of distortion in the allocation of exports and imports. So much so, that an undesirable imbalance between imports and exports may ensue (Krueger 1974, Cordon 1981). This problem might have been further aggravated by the undue restriction on foreign direct investment. That may have caused debt to rise to an unnecessarily high level which otherwise could have been addressed via foreign direct investment. The important implication of all that was that if the currency were allowed to float, then the mechanism of its appreciation and depreciation would ultimately bring a balance between exports and imports. This is, of course, the familiar adjustment process known as the J-curve effect, according to which devaluation would initially adversely affect the current account deficit, but after that it

would improve the situation continuously (Cordon 1981). Any remaining trade imbalance could be addressed via directly inviting foreign direct investment.

Accordingly, country after country joined the currency float fashion and the removal of financial controls. Also laws relating to takeover and merger activities were relaxed in anticipation that the threat of a takeover may improve the performance of those otherwise not performing as expected. In other words, the external sector of the financial system also had to be liberalized. Internal and external liberalization of the financial sector was undertaken with the expectation that this would bring efficiency to this sector. This in turn would improve the growth performance of those countries, and in the process it would open up the opportunity for financial capital to move freely from one country to another. The speed of that movement was further enhanced by the advancement in information technology. The combination of these latter two developments has given the impression that the financial markets are now perhaps truly globalized.

However, the problem with true globalization is that integration of the whole world should take place into one, in the sense that different parts of the globe should be merged into one. In the case of financial globalization, this means lending and borrowing countries should be merged into one market. Assuming such a process has indeed began as the free movement of finance may indicate, then liberalization has removed one barrier. At the same time, though, this has also brought a series of financial crises.[5] Although these financial crises are similar to those that were observed between 1870 and 1914, their magnitude, and frequency, has been a great deal larger. The following question emerges at this stage: could the experience of that era, whereby the process of integration brought crises, itself be conceived as a serious constraint to the financial process? The problem is that the process of integration requires development of international institutions and the introduction of a single currency. The vital importance of both has been over looked so far. The need for the development of a global institution

[5] The experience of that era has produced an interesting view that "developing countries need to have a set of preconditions in place to benefit from financial globalization and to avoid an increased probability of a currency or banking crisis" (Dawson, 2003, p. 9). The main elements of this "cautious" approach, supported by the IMF, are: "First, the long end of the market should be opened up before the short – that is, foreign direct investment should come before portfolio flows. There may be a case for imposing or retaining some capital controls, especially price-based controls on short-term flows ….. Second, the institutional and regulatory regime in the financial sector is very important. A strong prudential regime should be in place before the capital account is fully liberalise" (Dawson op. cit., p. 10).

principally arises from the fact that there is a need for a player to perform a central coordinating and regulatory role between borrowing and lending countries' financial institutions. For this coordination, rules have to be developed which all participating parties should accept. A vital aspect of such a rule is the regulation of the globalized financial system. We are far from having such a rule, let alone an appropriate institution to implement it. We return to this all-important aspect below.

Furthermore, and perhaps of equal importance, there is a need to introduce a single international currency. This is necessary for the two following reasons. The first is related to the existence of different currencies across the globe itself signifies that the market is not integrated but segregated. This segregation principally arises from the fact that different currencies carry different degrees of convertibility in the international market. As a result, currencies, which carry a low degree of convertibility, would have to be converted to currencies with relatively high degree of convertibility. Foreign loans is a case in point, in that when they have to be paid in currencies of those countries which carry a low degree of convertibility, this process inevitably limits the process of globalization. This is so for the simple reason that access to the foreign loan market will be crucially determined by a limited number of countries. The countries that would qualify in fact would be those countries with sufficient export sectors earnings, which would determine their capability to repay the loan in foreign currencies. This means only the export sector of these countries would be integrated, the remainder of the domestic market will fall outside the orbit of globalization.

The second reason for the need to introduce an international single currency, relates to the problem that arises from the fact that loan markets operate in the presence of uncertainty. In this market, therefore, lenders are required to introduce a credit standard, which includes collateral or some other form of security, as an alternative means of payment, should the projects' return not be sufficient to meet the debt obligation. The existence of different currencies with different degrees of convertibility in the international markets also causes a problem in introducing uniform credit standard across the globe. For the international financial markets, domestic borrowers are required to have an international marketable asset in order to meet international credit standard requirements against which they can obtain loans.

Currencies with a relatively high degree of convertibility are able to offer a range of acceptable international marketable assets, and as a result there is hardly any difference in their domestic and international credit standard requirements. By contrast, currencies with a relatively low degree of convertibility, are faced with a difference between domestic and international credit standard requirements. This segregates the domestic financial markets from the international financial market. A real difficulty then ensues not only in that a uniform credit standard across the globe cannot be introduced, but also that different countries have varying degrees of access to international financial markets.

## 4. PROBLEMS OF FINANCIAL GLOBALIZATION

Three problems are evident in the process of financial globalization. The first is that since the degree of currency convertibility power is low for all the developing countries, all their foreign loans have to be paid in foreign currency. In this situation, it is reasonable to assume that only the exporting sector is able to meet the international credit standards, since it is this sector that can offer international marketable assets, in view of its potential to earn foreign currency. But this is where the serious problem begins in the process of globalization. The problem here is a critical one. Since all the foreign loans have to be paid in foreign currency in the case of developing countries, only the assets of their exporting sector are acceptable in the international credit standard requirements. Not only does this limit the process of integration, but it also introduces another problem. The problem is that if the foreign loans are not used for the enhancement of export facilities, then the loan repayment no longer depends upon the project performance. This makes project evaluation irrelevant, and also implies that the credit standard no longer remains as an alternative means; it becomes the principal means of repaying the loan. In other words, credit standard no longer provides a security against which the loans are issued. This may explain why indebtness in certain countries is continuing to rise.

The second problem relates to the sufficient condition for integration, which is the country's ability to attract such financial capital (the analysis so far demonstrates that the

necessary condition for financial capital to move freely between countries is financial liberalization). This possibility to attract foreign financial capital ultimately depends upon the country's ability to offer international marketable assets as a security against which the country can seek a loan. Furthermore, this access improves as the size of a country's international marketable assets increases. Given the poverty of developing countries, it is reasonable to assume that their international marketable assets will mainly be comprised of those assets whose earning directly relates to the exporting sector.[6] This means that apart from a few industrialized nations, export-led growth economies will now have greater access to this global financial market.[7] As the export-led economies' growth rate rises, the value of their assets, which are particularly owned by the export sector, also rises in international markets. These economies, therefore, are able to borrow even more by offering a higher value of assets. This incremental rise in the value of these assets also attracts capital to directly purchase these assets with the expectation that they may make a profit from the expected change in their price.

There remains, though, a serious inherent problem associated with this form of lending. This is the possibility that loans may be advanced with the agreement that in the event of a default, the country would have to allow the foreign lender to sell their international marketable assets to recoup the proceeds of the loan. It was not recognized, perhaps that the repayment of the loan mainly in the case of developing countries, directly relates to the earnings performance of the internationally traded marketable assets. If the foreign loans are not used for the enhancement of export facilities, then the loan repayment no longer depends upon the project's performance. It is rather directly linked with the earning performance of the internationally marketable assets. In other words, these assets no longer serve the purpose for which the credit standard was introduced. The reason being that the repayment of the loans is not necessarily associated with project performance for which the loan was advanced,

[6] Greenspan (2003) maintains that further global financial development will be an advantage for developing countries because it "should lead to the enrichment and growth of developing economies as global savings are efficiently directed to capital accumulation in those countries where the marginal product of capital is highest" (p. 5).

[7] For example, the twelve main recipients of foreign capital in decreasing order were China, Mexico, Brazil, Korea, Malaysia, Argentina, Thailand, Russia, India, Turkey and Hungary. For more details on this issue, see Harris (1998) and World Bank (1997).

but rather is associated with the performance of the alternative means to repay the loans. This means repayment of the loan is independent of the project performance. In this case, capital plays a purely redistributive role. Whether the loan has been used for the enhancement of export facilities or not, the process will ultimately be locked into the global financial market and the expected growth in the value of the emerging markets' export sector.

The problem here is that if the expected growth rate does not materialize, then the fall in export earnings will not only cause a problem for maintaining the repayment of debt. Furthermore, since the value of these assets is also linked with their earning potential, a fall in expected earnings will also cause a fall in the value of these assets. This in turn will increase the credit risk to a very high level. In other words, a collapse in the assets' value will no longer be able to protect foreign lenders' loan capital. This scenario can either be described as over lending or over borrowing or else over investment. This situation can first lead to a banking crisis and then to a currency crisis.

A similar situation might have emerged during the last so called globalization that took place during the height of the industrial revolution, where the demand for raw materials and the expansion of railways led financial capital to move from one country to another. The problem was expansion of the railways might have integrated the domestic economy, but the repayment of the loans for the expansion of the railways depended on the export earnings from the raw materials. This, however, alone was not sufficient and in the process this may also have caused periodic over investment and led to the emergence of a variety of regulations. In this sense, this globalization may not be altogether too different from the last one.

A third problem is directly related to the impact of financial globalization on macroeconomic volatility. This is another important dimension of financial globalization, which has not received much attention in the literature. Indeed, it is particularly pertinent to the developing countries in view of low levels of physical capital and inherently greater volatility in their case, than in developed countries (a number of studies have dealt with the apparent "declining" volatility of output in the U.S. and other developed countries; see, for example, Blanchard and Simon, 2001; McConnell and Perez-Quiros, 2000). A recent study (Kose et al, 2003) shows that while "volatility of output growth has, on average, declined in

the 1990s relative to the three earlier decades ….. the volatility of consumption growth relative to that of income growth has increased for more financially integrated developing economies in the 1990s" (p. 4). This, however, happens only up to a threshold, defined as the point in terms of which "improved risk-sharing and consumption-smoothing possibilities" (op. cit., p. 4) entail clear benefits. Financial globalization, as measured by the ratio of gross capital flows to GDP, is beneficial beyond this threshold. It would appear to be the case, though, that financial globalization has heightened the risk of financial crises. This is particularly relevant before the threshold just referred to is reached, for the very obvious reason that since financial globalization amplifies cross-country financial linkages, shocks are transmitted more quickly across national boundaries than otherwise (Prasad et al, 2003).

The study by Prasad et al (2003) confirms these results. They concur with the argument that "consumption is regarded as a better measure of well-being than output" and that "There is little evidence that financial globalization has helped developing countries to better stabilize fluctuations in consumption growth" (p. 6). The evidence presented by Prasad et al (op. cit.), which draws on Kose et al (2003), "suggests that low to moderate levels of financial integration may have made some countries subject to even greater volatility of consumption relative to that of output. Thus, while there is no proof in the data that financial globalization has benefited growth, there is evidence that some countries may have experienced greater consumption volatility as a result" (p. 6).

The evidence presented in Prasad et al (2003) implies that a great deal of caution should be in order to unqualified support for financial globalization. It argues for "good institutions and macroeconomic frameworks" should be in place before financial globalization should be allowed at a grand scale. In terms of the optimal pace and sequencing of financial globalization, this study laments the "unresolved tension between having good institutions in place before undertaking capital market liberalization and the notion that such liberalization can itself help import best practices and provide an impetus to improve domestic institutions. Such questions can best be addressed only in the context of country-specific circumstances and institutional features" (op. cit., p. 5). It stops short, though, of including in the definition of "good institutions" the type of international monetary arrangements we suggest in the

current study. We turn our attention next to this type of international institution, in an attempt to elaborate on the issue upon which we have just touched.

## 5. FINANCIAL REGULATION

The existence of an international financial institution with sufficient power should be able to play the leadership role required to alleviate the problems to which we have alluded in our analysis above. The current international institutional arrangements do not appear to provide a global financial institution, which is prepared to play such a central co-ordinating role. Historically speaking, the only time the world ever came close to such a situation was during the late 19th century, when Britain was able to play a crucial and central role in world financial markets. Since then an attempt might have been made in 1944 but it collapsed in 1973, with the abolition of the fixed exchange rate by the U.S.. This led to the emergence of regionalism, which is perhaps still in a transitional phase (Harris, 1998).

Even if we assume that there is no need for such an institution, a problem still remains with integration. This problem principally arises from the lack of a single currency, in the absence of which it is not possible to bring uniformity in the implementation of credit standards. As the loan market operates in the presence of uncertainty, there is a need to introduce credit standard in order to ensure that should the borrowers' project fail for which the loan was advanced, there remains an alternative means to repay the loans. This problem principally arises from the fact that integration requires individual nations to have the ability to attract financial capital, which is independent of external barriers. Integration is then mainly determined by the internal state of the economies of the countries concerned and the future opportunities these economies can offer. Another important ingredient to this process is that of removing the "home bias." Greenspan (2003) discusses this issue and suggests that "A clear benefit of financial globalization is that, to the extent that it reduces home bias, savings will be better directed to the most promising investments in the world, increasing global economic growth and prosperity. However, so long as risk aversion exists and trust is enhanced by local familiarity, we cannot expect that home bias will fully dissipate" (p. 3).

The analysis that has been provided in this paper so far, suggests that unregulated opportunities for financial free flow between countries are a by-product of financial liberalization. But this opportunity for free financial flow between countries, does not alone constitute financial globalization. To complete the process of financial globalization there is need first to develop a global institution which can play the central coordinating role, and more importantly for the purposes of this paper, to regulate the system. In addition to this requirement, there is a need to develop a single currency, which neither depends on gold nor on any national currency. It is the single currency that will allow global financial market to develop a uniform credit standard requirement. As it stands at the moment, the export sector of the developing countries has been used as a proxy to credit standard, which also acts as the central means to repay the loan. Therefore, any negative performance of this sector would produce difficulties in recouping the loan, which in turn will bring periodic financial crisis. This aspect has been developed extensively above. The regulation aspect is the one that needs to be further developed.

We maintain that credible and transparent regulation, to support and manage a genuinely international single currency is paramount. Under current international institutional arrangements, the International Monetary Fund (IMF) can easily undertake this function. This could be implemented with very little cost, in terms of finance, non-human and human resources. A revamped IMF can manage such operation in order to prevent major financial crises through credible intervention, and help country lending and borrowing in a transparent way. It should not be compelled to lend by powerful members or by borrowers who threaten to default, a most prevalent experience currently. This could easily be achieved by establishing a truly independent IMF. Indeed, such regulation may embrace those aspects suggested by Keynes (1980) in his *International Clearing Bank* (ICB) proposals for the post second World War II international financial order.

The main relevant elements of the ICB may be summarized: the establishment of a truly international central bank with the power to issue a single international currency, the Bancor in Keynes's (op. cit., p. 72) terminology. The Bancor should be "fixed (but not unalterable) in terms of gold and accepted as the equivalent of gold ….. for the purposes of

settling international balances" (Keynes, op. cit., p. 72). The ICB should also be empowered to intervene in capital and financial markets to provide sufficient liquidity for the needs of international trade. National central banks would keep accounts with the ICB, so that normal banking "account clearing" can take place. The idea and the principles of the ICB are really very simple and are based on generalizing "the essential principle of banking, as it is exhibited within any closed system. This principle is the necessary equality of credits and debits, of assets and liabilities" (Keynes, op. cit., p. 72). Under these arrangements, the ICB "can with safety make what advances it wishes to any of its members with the assurance that the proceeds can only be transferred to the bank account of another member. Its problem is solely to see to it that its members behave themselves and that the advances made to each of them are prudent and advisable from the point of view of the Union as a whole" (Keynes, op. cit., pp. 72-73).

A revamped IMF, along the lines of the Keynes' ICB would issue an International Clearing Unit (ICU) to serve as a medium of exchange and reserve asset. The ICB would issue ICUs in return for gold, dollar and other reserves of member central banks. ICUs should only be held by central banks, and in more general terms the ICB would operate as an institution which periodically would settle outstanding balances between central banks. The ICA would, therefore, be a "double-entry book-keeping clearing institution, providing overdraft facilities so that unused credit balances could be mobilized efficiently and effectively. It should be committed, along with member central banks, to guaranteeing one-way convertibility from ICU deposits to domestic money.

A sister institution should also be created, here again a revamped World Bank. This should be an International Investment Agency (IIA) with two specific aims. The first aim should be to provide finance for investment, especially to the developing and emerging countries, which need to industrialize in a way that does not enhance dependency on the developed economies. The second aim should be to provide lending facilities to enable countries to avoid foreign exchange difficulties. This aspect of the proposal relies on the notion that countries are at different stages of banking and economic development and as such they do not run continuously balanced current accounts. The IIA attached to ICB should

provide the necessary lending to enhance investment opportunities of the borrowing country, and in the case of developing and emerging countries such lending should be linked to industrialization. Creditor countries should be expected to introduce appropriate policies to reduce their surpluses.[8]

## 6. SUMMARY AND CONCLUSIONS

This contribution can be briefly summarized. As the international economic landscape stands at the moment, we are still a long way away from true financial globalization. A more recent development is even more restraining for financial globalization. If the argument that national stock markets moved on the whole in harmony in the period from roughly the early 1980s to the beginning of the recent bear market (March 2000), an interesting implication follows. This is that with the bear market entering its fourth year, there is evidence to suggest that stock markets no longer move in harmony (as reported in the Financial Times, 22 April, 2003); individual country risks becoming an important factor (witness the current economic performance in countries like Brazil and Argentina; see Financial Times, 24 April, 2003). This, it is suggested, could very well mean that stock markets are "signalling a retreat from globalization" (Financial Times, 23 April, 2003).

Financial liberalization alone does not constitute financial globalization. The process of financial globalization can only be completed if a global financial institution is developed and created that can play a central coordinating and regulatory role. Alongside such an international institution is the requirement for an international single currency, which does not depend on any national currency. Such a currency will allow the global financial market to develop uniform credit standard requirements. We have put forward the essentials of a system that is necessary for a true financial globalization.

[8] See, also, Davidson (2003) for a proposal along similar lines as Keynes's (1980). Stiglitz (2002) argues for substantial changes to the IMF, the World Bank and the WTO, in a proposal to reform the global financial system.

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