The Macrotheme Review

A multidisciplinary journal of global macro trends

FINANCIAL GLOBALIZATION, "BARRIERS OR BENEFITS" FOR DEVELOPING NATIONS OF THE WORLD

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Abstract

This paper is basically an exploratory analysis. Financial globalization seen as the integration of a country's local financial system with international financial markets and institutions has improved global welfare. This paper identified governments, financial institutions, borrowers and investors as main agents of financial globalization. Development of a country's financial system, infrastructure, increase in world trade and output, increase in welfare of citizens among others were noted as some of the prospects of globalization. Issues such as financial crises, poor technology, rapid spread of shocks and disturbances, difficulty in controlling effectively the movement of capital across national boundaries including increase in unemployment of low skilled labour were identified as major challenges facing financial globalization. Although financial globalization has many positive and negative aspects, there is no doubt that it has improved individuals across the globe. Thus, this paper recommends that there is the need to improve the technology base of developing countries as well as the need to put in place sound financial system and infrastructures in these economies.

Keywords: Financial Integration, Financial System, Globalization, Output, Technology, Trade

1.0 Introduction

"Developing", "less-developed", "under-developed" and "third world" countries are terms used to describe the same class of countries which suffer from economic underdevelopment (Ujah et al, 2007). Economic underdevelopment here refers to the stage at which the rate of growth of domestic savings are not enough to finance the investments needed for better development of an economy. Our country Nigeria and many other African countries fit into the description of developing countries. These countries generally exhibit certain features such as high level of poverty, low per capital income, high degree of illiteracy, low savings and investments, high birth and death rates. Other features include low level of technology, high degree of unemployment, and agriculture as main occupation, likewise exportation of raw-materials as a result of low level of technology which may not support the processing of these raw-materials into semi-finished and finished goods.

Financial globalization is not a new phenomenon. Capital flows have existed for a long time. Although developed countries are the most active participants in the financial globalization process, developing countries have also started to participate. Financial globalization according to Sergio (2004) is the integration of a country's local financial system with international financial marketing and institutions. This integration typically requires that governments liberalize the domestic financial sector. Integration takes place when liberalized economies experience an increase in cross-country capital movement, including an active participation of local borrowers and lenders in international markets and a widespread use of international financial intermediaries. The potential benefits of financial globalization will likely lead to a more financially interconnected world and a deeper degree of financial integration of developing countries with international financial markets. Probably, the main benefit of financial globalization for developing countries is the development of their financial system. Levine (2001) posits that a better functioning financial system with more credit is key because it fosters economic growth.

Financial globalization is propelled by advances in information and communication technology (ICT) that facilitate interactions among financial concerns in different parts of the world (Ituwe, 2005). Over the past two decades, world output has been expanding and many countries are benefiting from increased cross-border production, trade and investments. Others also suffer due to the fact that economic regimes are inefficiently managed and this challenge or weakness reduces their ability and capacity to successfully compete on the global level (Schneider and Enste, 2002). The events in the last decade in the global economy suggest a challenge; the utilization of the opportunities engineered by globalization while at the same time, managing the challenges it poses for developing countries like Nigeria. While scholars such as Dani (1999), David (1997) and Salimono (1999) see globalization as a platform which opens opportunities, others like Awake (2002) and Gary (1998) as cited in Ngige (2013) express fear about globalization. Rugumamu (2001) posits that globalization is not merely a buzzword; rather a new strategy in international business relations which apparently signals the triumph of capitalism on a truly global scale following the end of the cold war, the collapse of the soviet system and the dissolution of the planned economies, particularly in Eastern Europe. Scholte (2000) lends credence to this observation by seeing globalization as a de-territorialization or rather as the spread of supra-territoriality. He opines that the phenomenon constitutes a transformation in the spatial organization of social relations and transactions.

Based on the picture painted above, this paper attempts an exploratory analysis of the concept of financial globalization, its prospects and challenges in Nigeria – a prominent developing country in the world.

1.1 Definitions of Financial Globalization

According to Kareem (2009), there is no consensus on the definition of globalization in the development literature. Globalization deals with the increasing breakdown of trade barriers and the increasing integration of world market

Globalization according to Tandon (1998), as cited in Orga (2005), seeks to remove all national barriers to the free movement of international capital and this process is accelerated and facilitated by the supersonic transformation in information technology. Globalization is principally of ideas, cultures, values and even life styles. Gordimer (1998), as cited in Ngige (2013), argues that it is basically concerned with the expansion of trade over the oceans and airspace, beyond international alliances which were restricted by old political spheres of influence. Mishikin (2003) sees financial globalization as a process by which domestic markets of different countries are being linked together by a natural international economic evolution. Ohmae (1989) maintained that globalization means the integration of financial markets throughout the world into an international financial market. Ude (2000) defined financial globalization as a process by which domestic financial markets of different countries are being linked together by a natural economic evolution.

From all the definitions and others, it can be argued that financial globalization is mainly a phenomenon of capital mobility. Its two prongs are: foreign direct investment and international one which is dominated by transnational boundaries and domestic economic considerations. Globalization refers to a situation in which the whole world is seen or looked at as a single community that is connected by electronic communication systems (Ituwe, 2005). It reveals that in life, everything is connected. With globalization, happenings and activities in the various parts of the globe are brought to the knowledge of people across the world via the internet. It is important to note here that the early proponents of development economics were of the view that growth can be internalized. However, recent developments in the world economy show that it is futile for countries to isolate themselves in a rapidly integrating world.

2.0 Main Agents of Financial Globalization

The three major agents driving financial globalization across the globe include governments, private investors and borrowers and financial institutions.

Governments

Governments allow globalization by liberalizing restrictions on the domestic financial sector. The government regulates the domestic financial sector by restricting the allocation of credit through controls on prices and quantities. Governments also impose several constraints on cross-country capital movements. Such restrictions include restrictions on foreign exchange transactions, lending and borrowing activities by banks and corporations and the participation of foreign investors in the local financial system.

Borrowers and Investors

These including households and firms have become main agents of financial globalization. By borrowing abroad, firms and individuals can relax their financial constraints to smooth consumption and investment. Firms can expand their financing alternatives by raising funds directly through bonds and equity issues in international markets and thereby reducing the cost of capital, expanding their investor base and increasing liquidity. More financing alternatives help foreign investors overcome direct and indirect investment barriers. International investors as argued in Obstfeld (1994) and Tesar and Werner (1998) have taken advantage of financial globalization to achieve cross-country risk diversification.

Financial Institutions

Financial institutions, through the internalization of financial services, are also a major driving force of financial globalization. At the global level, the gains in information technology have diminished the importance of geography, thus allowing international corporations to service several markets from one location. The financial institutions parade products and services which encourage and promote financial globalization, e.g. credit cards, debit cards, mobile banking facilities, ATMs, fund transfers etc.

3.0 Prospects of Financial Globalization

Financial globalization which has been described as the integration of financial markets throughout the world into an international financial market has a lot of prospects for both developing and developed economies of the world. Some of these are pointed out below:

1. Financial globalization has the potential to lead to development of the financial system. A well functioning financial sector provides funds to borrowers (households, firms and governments) who have productive investment opportunities but may lack the necessary funding to finance them. As pointed out in Muskin (2003), financial system does not usually operate as desired because lenders confront problems of asymmetric information which can lead to adverse selection and moral hazard.

2. Again, the effects of capital flows on financial development take place because new sources of funds and more capital become available. New sources of funds will mean that borrowers not only depend on domestic funds but can also borrow from foreign countries willing to invest in domestic assets. The capital available from new sources mean that market discipline is now stronger both at the macroeconomic level and at the financial sector level and at the financial sector level, as now local and foreign investors enforce market discipline on private and public borrowers. Foreign capital is particularly effective in imposing this kind of discipline given its footloose nature; foreign capital can more easily shift investment across countries. Domestic capital tends to have more restrictions to invest internationally.

3. Financial globalization can improve the financial infrastructure. An improved financial sector infrastructure means that borrowers and lenders operate in a more transparent, competitive and efficient financial system. In this environment, problems of asymmetric information are minimized and credit maximized.

4. Furthermore, foreign banks entry is another way through which financial globalization can improve the financial situation of developing countries. This is true because these banks have more diversified portfolios as they have access to sources of funds from all over the world. What this translates to is that they are exposed to less risk and are less affected by negative shocks to the home country economy.

5. With financial globalization which opens the door for foreign banks and financial institutions to participate in the financial system, this situation leads to the adoption of world best practices in the banking industry, particularly in risk management but also in management techniques. This leads to a more efficient banking sector. Again, with this situation, governments are less likely to bail out banks when they have solvency problems. A lower likelihood of bailouts encourages a more prudent behaviour by banking institutions, an increased discipline and reduction in moral hazards.

6. Globalization has the potentials of penalizing countries that adopt the wrong macroeconomic and sectoral policies, while enhancing the growth potential, of those that apply sound policies, (Orga, 2005).

7. The increase in world trade and output made possible through globalization ensures that consumers derive the best satisfaction since the best standards of quality are maintained through specialization and competition. In addition, the volume of goods and services increases with the welfare of individuals enhanced across countries.

Therefore, countries must strive to adopt policies that are in consonance with the current reality of the rapid integration of the world economies.

4.0 Challenges of Financial Globalization in Developing Countries

Despite the huge prospects and benefits of financial globalization to developing countries of the world, it carries some challenges or risks. These challenges are more likely to appear on the short run, when countries open up. Among them are:

1. Financial globalization can lead to financial crisis in countries. The cases of the 1997-98 Asian and Russian crises, as well as those in Brazil 1999, Ecuador 2000, turkey 2001, Argentina 2001, and Uruguay 2002 are just examples captured worldwide (Sergio, 2004). Even though domestic factors tend to be key determinants of crises, there are different channels which financial globalization can be related to crises. First, when a country liberalizes its financial system, it becomes subject to market discipline exercised by both foreign and domestic investors. When an economy is closed, only domestic investors monitor the economy and react to unsound fundamentals. In open economies, the joint force of domestic and foreign investors might generate crisis when fundamentals deteriorate. This might prompt countries to try to achieve sound fundamentals, though this might take a long time. Furthermore, investors might over-react, being over-optimistic in good times or over-pessimistic in bad ones, not necessarily, disciplining countries. Therefore, small changes in fundamentals, or even news, can trigger sharp changes in investors' appetite for risk.

2. Lack of competitiveness in the technology sector. Globalization is driven by a rapid technological revolution and a nation that is creative and innovative in the technology sector will be highly competitive in the global economy. Unfortunately, Nigeria is not so well endowed in terms of creativity and innovation in the high-tech sector. The fallout of this is that even though our nation Nigeria has been liberalizing its economy, the real sector functions under conditions of inadequate technology to boost their outputs. This has proved to be a big challenge in strengthening the productive base, especially agriculture and industry, in order to make them more export-oriented (Ngige, 2013).

3. Apart from making the pursuit of independent monetary policy difficult, globalization increases unemployment in those countries with relatively low skilled labour. This is because labour mobility in higher under globalization. Essentially, globalization tends to encourage policy interdependence while reducing national policy sovereignty, especially for countries with uncompetitive economies.

4. With rapid integration financial markets, it becomes difficulties to control effectively the movement of capital across national boundaries (Doughty and Edward, 1995).

5. Another challenge of financial globalization is the rapid spread of shocks and disturbances from one financial market to another. Although, such stocks can be absorbed by large markets, they nevertheless constitute obstacles to the achievement of macroeconomic stability (Kwanashie, 1992).

6. Excessive growth in investment, financed by foreign capital when domestic savings are low could result to in difficulties for macro-economic stability, as there may not be enough people with the purchasing power to patronize the products and services gotten from such investment.

7. Another risk of globalization is the segmentation that it can create between those able to participate in the global financial system and those that need to rely on domestic financial sectors.

5.0 Conclusion and Recommendations

This paper has reviewed the meaning and nature of globalization, its prospects and challenges. It also identified the fact that financial globalization has both positive and negative aspects. However, on a general note, financial globalization has improved global output, trade and welfare of citizen across the world and has also helped in developing the financial system of various countries:

Thus, to ensure that developing countries fair well side by side with developed countries in globalization, the following are recommended:

1. There is the need to improve the technology base of developing countries. Financial globalization is anchored on sound information and communication technology (ICT) base.
2. Governments should also put in place, sound financial system and infrastructure in developing countries. Financial instruments and good regulations are needed for effective functioning of financial globalization.
3. There is also the need for the creation of a conducive regulatory environment and climate in order to boost business activities with foreigners.
4. A stable political, social and economic environment devoid of social and political unrest as well as terrorism is required in Nigeria and other developing countries to attract foreign direct investment (FDI).

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