JANICE SANON

FINANCE AND GLOBALIZATION

Margin Call is an American drama written and directed by J.C. Chandor in 2011. The movie related the 36 hours prior to the financial crisis, when the employees of an investment bank realized the existence of toxic assets jeopardizing the survival of their bank. Against all odds, the protagonists intended to throw away these assets while fully realizing the outcomes which may occur both on a social and an economic side. Cynical isn't it? However, this is how financial in the globalization works. One event affects the rest of the chain. The movie manages to highlight the difficulty and the dangerousness of international finance, its lack of concern for human lives and the very thin links which mingles global finance and global economy to one another.

Finance is defined as a field dedicated to manage large amounts of money, allocating assets and liabilities to those who requires it. Finance is at the heart of capitalism and its main mission is to collect funds from agents (individuals or institutions) who do not want to use them straight away and lend them to other agents (company, states) who on their side needs to invest in producing goods and services. Financial circuits ease up the processes between those who want to invest and those who wants to save their assets.

The globalization on its side is the processes of interdependence between countries' economies, territories and societies on a global scale. Spier defined the globalization as waves. The first one was triggered by the European transatlantic trips towards the end of the 15th century. The second wave happened in the end of the 18th and beginning of the 19th century and Spier defines it as the the outcome of industrialization with the Industrial Revolution. The third wave is an on-going wave associated with the current information technology revolution: electronic computers, global electronic networks, modern data technology and most importantly the third wave coined the term globalization itself. Globalization is the triumph of one single economic system – liberal capitalism, which can be summarized by Rodrick's trilemma and in our case it is the symbol of the decrease of the power of the States and Governments. The financial networks produced 40 times more outflows than the trade ones. Some researchers even refer to the expression "financial globalization" meaning that there is a creation of a single market ruled by cash flows. Between rich and emerging countries, the control of capitals has disappeared while currencies depreciate or appreciate. The liberalization of the financial outflows between territories came along with the internal liberalization which deleted the barriers between financial areas and institutions and more particularly banks. In 30 years, finance has become one the principal dimensions of the globalization.

The question which arises to me is therefore the following; ***how does the financial globalization reflects the geopolitical and geoeconomical issues in our world?***

I will first and foremost explain how finance managed to gain a key role in globalization. Following this historical part, I will explain how due to that role, finance has polarized both the risk and the instability in the world economy. Finally, I will end with an explanation of how the synergy between finance and globalization is reshaping the world.

***

The synopsis.

The 19th and the beginning of the 20th century have seen the outbreak of international finance. Financial flows have drowned financial institutions who in returned were charged to take care of them. This last twenty years, the cumulated value of financial assets and bonds was multiplied by four (from $56 000 billion to $225 000 billion between 1990 and 2012). In total this amount is equal to seven times of the world GDP. However, the degree of financialization of national economies is defined by the weight of their financial assets, and this vary from one country to another. Indeed, in the USA it is equal to 480% (2012), in Japan 450%, in Western Europe 370%, and in China 225%. However, it is lower in countries like India 150%, or areas like Latin American 125%.

The way assets are gathered in one part of the world draws a whole new way to see the world map. For instance, FDI flows from multinational (joint ventures and acquisitions) have kept increasing since 1985. The only event which really lowered these flows was the 2008 crisis. But, in 2011, FDI were estimated at $1500 billion – the latest record was at $1833 billion in 2007. In regard to the geographical concentration of these flows, they are mostly gathered in North America, Europe and Japan (triadization). That dynamic is reflective of the way finance operates geographically: in fact, 50% of the FDI are going to developed countries, 44% of the investments go to developing ones, and 6% towards South-Est Europe and the CIS.

The stock exchanges are representative of the geolocalisation of finance. In fact, the major stock exchanges are located in the North – although, if we were to add Chinese stock exchanges together, China would be the world second location for finance. Nonetheless, finance is a market extremally polarized, in fact, 85% of the world capitalization is located in only 20 stock exchanges: Europe, North America, and South East Asia.

Most of the financial flows are handled by the few leaving a small margin – or none, to the rest of the world. Developed countries, and large cities are the centers of power, centers of finance, and therefore the centers where the world economy starts. They reflect the geopolitical and geoeconomical challenges. In *The Global City* (Princeton, 2001) Saskia Sassen calls cities like New York, London, Tokyo and Francfort "global cities" because they all have the features which make them global and central places for finance and economy: they are financial hubs, with a strong economy, their currency quote is solid, and they possess financial equity, their financial institutions are powerful, they use high technology to develop themselves and finally they all take advantage of a liberal system enabling them to trade faster.

We are witnessing a financial globalization which recalls Laurent Carroué's definition: first, we have a mature financial markets located in developed, wealthy and powerful countries (the Triadization, Hong Kong and Singapore). Then there is the emerging financial markets which are still shaping themselves and are adopting a liberal economy (the BRICS, South Korea, Taiwan, Argentina, Israel, Poland). And finally, Carroué explains that the last group can be assimilated to the Third World, where the economy, the polical and social basis are still weak and unstable.

Financial globalization is the result of a path which was curved at the end of the 1950's with the rise of the Eurodollars in London. In 1976, the Jamaican Accords officialized the end of the Bretton Woods system (established in 1944) – the dollar cannot be converted into gold anymore. The Jamaican Accords lead to an outbreak of currencies and to floating exchange rates. The petroleum crisis in 1973 and 1979 increased that trend and the number of capital flows, and the OPEC started to accumulate petrodollars enabling them to become wealthier.

The most effective disruption happened in the 1980's with Margaret Thatcher in the United Kingdom (1979-1990) and Ronald Reagan in the United States (1981-1989). These respectively conservative and republican governments contributed to the liberalization of the economy, and the rules which were driving finance and public institutions since the 1929 crisis. That era is called the direct finance. It started to gain the rest of the world in the 1990's and the new system was summarized by the 3D created by Henri Bourguignat in *Les Vertiges de la finance international* (1987):

- **Disintermediation**: banks no longer play the role of intermediary and they are replaced by financial markets
- **Deregulation**: this corresponds to the break of the barriers for capital circulation. In the UK for instance, Margaret Thatcher launched in 1986 the "big bang".
- **Decompartmentalization** ("décloisonnement"): which is the elimination of the separation between investment banks and commercial banks. For instance, in the USA the Glass-Steagall Act (1933) was replaced by the Gramm-Leach-Billey Act authorizing banks to be both investment and custodian banks.

Some researchers added to Bourguignat's system a fourth "D" for **Dematerialization**, meaning that nowadays, with the technological progress, financial markets are interconnected 24/7 and that we now have to refer to a global financial system when we speak about stock exchanges, and finance in general. This is how the link between globalization and finance was created. When New York and Chicago close their deals, Tokyo takes over followed by Hong-Kong, Bahrein, London and again New-York and Chicago re-open.

***

This brief geographical history of finance leads us to where we are now. Because finance is interconnected and induced into the world economy, finance has managed to polarized both risk and instability for the world economy.

***

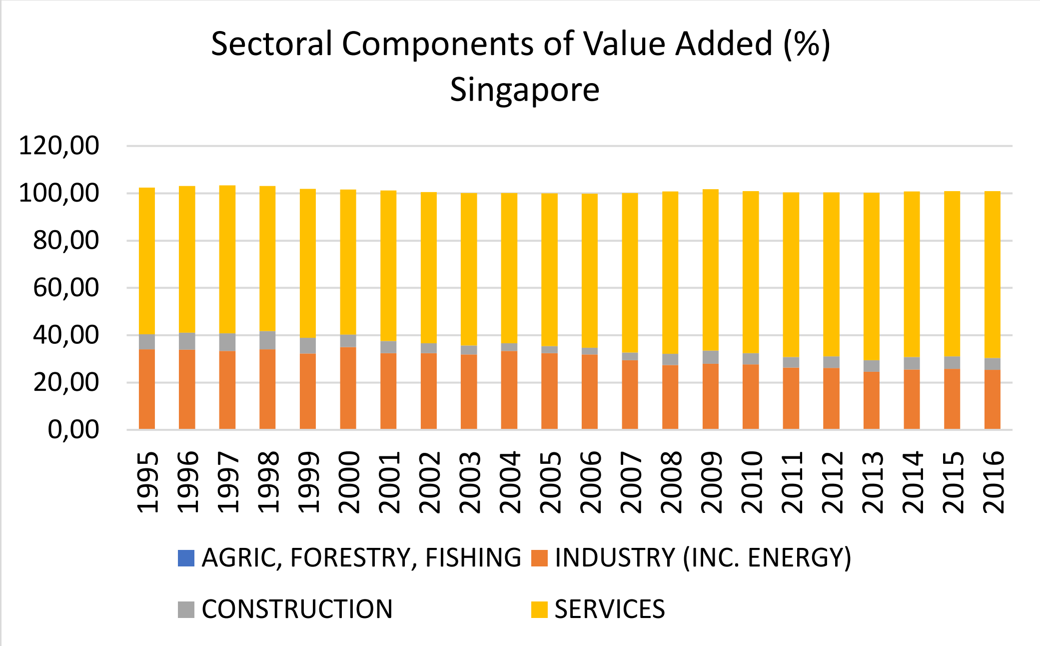
The actors.

Markets are nowadays more instable than ever. Speculation on money, on commodities, on goods and services destabilized countries' economies. The fluctuation of the offer and the demand offers more opportunities to speculate however, this is more affecting countries. Financial markets are themselves more profitable: assets and bonds are being exchanged more than ever. Flows of money ("hot money") creates sometimes speculative bubbles which is the highest risk because when they explode they create cracks. The birth and rise of derived products increased the instability and the risks. In that kind of system, the actors are the most terrifying. In fact, we still have traditional actors (such as banks, insurances, companies, States and households). But to that, we added institutional investors, hedge funds, and speculative funds. Although traditional actors still rule global finance, they are the one making risky choices with actions and creating instability. The accumulation of the dividends, stock options, golden umbrellas are for instance some witnesses of the gain of the powerful over the many.

In that kind of lifestyle, we may wonder what is the role of institutions such as the World Bank, the IMF and so forth. The IMF, for instance, was set up along with the Bretton Woods in 1944 to insure the stability of the international monetary system and avoid financial crisis. Private institutions were also created in order to control investments and liability like the rating agencies: Moody's, Standard & Poors and Fitch Ratings. However, seeing the 1997 Asian crisis or more globally the 2007-2008 crisis, the global public wondered whether theses institutions really made the most to avoid the worst. This lead States at the forefront of the action in order to regulate and defend their interest. Nonetheless, the liberalization was already a big part of the system – and I believe it was then too late to withdraw it.

The creation of tax heaven is the symbol of the failure of States to control global finance, and the mostly the symbol that finance controls the world. The IMF identified 70 tax heaven in the world and the OECD 47. They are mostly located in the Caribbean islands, but we can also encounter them in the British/Norway islands such as Jersey, Guernsey, and Isle of Man.

The fact that finance is part of the economy shows many terrifying consequences on societies. Since the 1980's capitalism transformed the world, and under the effects of the financial globalization, capitalism transformed financial markets, states, societies and cultures, technology, economies, and companies. We can wonder until where these changes will go. Over time productive systems changed: services took over agriculture, and industries. In countries like Singapore or South Korea services are the only way to thrive:



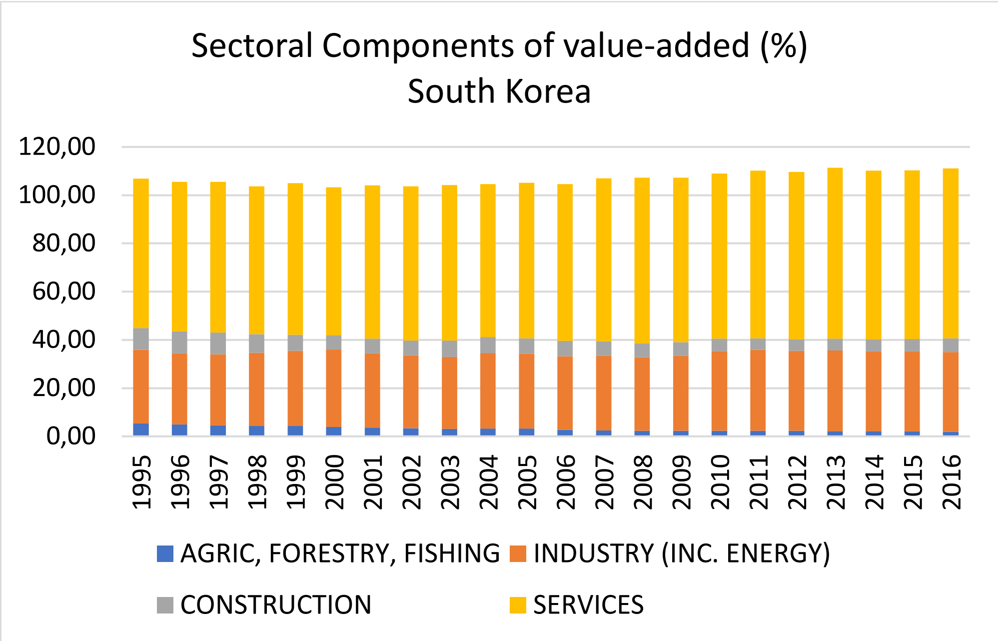


Table 1 & 2: *Sectoral Components of value-added (%) Singapore and South Korea* (Data Analysis, Sources: World Bank, OECD)

(Singapore being a particularly interesting example since in 1965 at its independence, it was part of the Third World and over time it became a hub for global finance and FDIs.)

This service-based economy has created major gaps, and inequalities in countries. In that kind of state, unity is the only way to survive for some. For instance, RFI (Radio France

International) broadcasted a documentary about Scottish Farmers refusing Brexit because 70% of their production is exported to the rest of Europe thanks to agreements. Leaving the EU would mean losing deals, and advantages and therefore being less profitable. Another example, of the rise of the instability is the repartition of wealth and the indebtedness of households. In the USA 1% of the richest owned 18% of the revenues in 2013 and alternatively, the rest of the population struggled to keep their standards of living and one representative example of that wealth gap was the subprime crisis.

Financial risks do not only affect external actors, but also finance itself. For instance, the bankruptcy of the famous bank Barings (UK) caused by risky financial operation of Nick Leeson on Singapore stock exchange is a symbol of finance harming itself. Earlier, we spoke about the subprime crisis and in fact that crisis affected households but it also fragilized international finance. Rating agencies became less trusted, investment banks were weakened – it led for example to some mergers and acquisitions to save some of them: J.P Morgan became JPMorgan Chase, and some financial firms were dismantled (Lehman Brothers).

***

Thus, the tentacles of finance are long and poisonous. And given the state of the world we may wonder how the world map is being reshaped every day.

***

Season 2

Economic, and financial crisis created against all odds a system which we can cannot rewind. Nicholas Shaxson, referred to the "finance curse" in 2018 to explain that **"***once a financial sector grows above an optimal size and beyond its useful roles, it begins to harm the country that hosts it. The results include lower economic growth, steeper inequality, inefficient markets, damage to public services, worse corruption. and widespread damage to democracy and to society."* The period of recession and inflation which followed the subprime crisis can illustrate that financial curse perfectly. Although, the triadization is still powerful, it lost a share of this power to the rest of the world enabling other regions of the world to expand themselves. I am referring to China taking over the African continent, or United Arab Emirates becoming a center for the world economy and other emerging countries making their way through globalization through soft powers: Nigeria with Nollywood, India with Bollywood etc. Between 1980 and 2000, the North owned 80% of the GDP, in 2015, according to the IMF it possessed 60%. The GDP in the South grew from 24% to 40% between 1980 and 2015. The growth of China, Brazil, India and Russia are part of the reasons for that growth. The evolution is also symbolized by the raw materials prices. From 1960 and 2000, prices were under the rules of developed country. But from 2000 and until 2000, we witnessed an upside down situation where prices doubled or even tripled. China is playing a major role in the shift of these prices. After the reforms in 1978 and 1992, it progressively opened itself to the world adopting a market-based economy. Nowadays, it is the first demographic power (1.3 billion), the first exporter worldwide, the first industrial power, and – depending on the sources, the first or the second economic power. Towards, 2020-2025 it may become the first banking power in the world. It already has the highest reserve of currency (40% of the world total) and the Yuan keeps being appreciated – *although this makes Trump very unhappy.*

The rise of the emerging countries led and is leading to the renewal of the international division of labor. It used to be a very simple scheme with the North exploiting the South. However, nowadays we are witnessing South-South exchanges with FDI's, labor markets and even immigration markets.

***

Conclusions or features to consider for a third season.

The question which arises to me after writing this essay is the following one: is finance still attractive? In fact, yes, it is. Finance still has an important weight in the world GDP and keeps creating jobs all around the world. Moreover, the new developments of finance such as microfinance, the development of circular economy, Islamic finance, the uberisation of the economy, the bitcoin, the blockchain to name but a few... All those types of finance are modifying the way traditional finance and actors operates. None of them seem to be ready for it although with the technological advances such as the Artificial Intelligence, we should be more than ready to react.

All these topics are to be looked and measured closely. The fact that finance in the first episode unleashed itself and broke itself – by itself, enabled all types of finance to arise. And this new developments represent the challenges of the globalization.

REFERENCES

J.C. Chandor, *Margin Call*, 2011

Fred Spier, *Big History and the Future of Humanity,* Wiley-Blackwell, 2019

Dani Rodrik, *The Trilemma of the World Economy*, 2011

Saskia Sassen, *The Global City*, Princeton, 2001

Laurent Carroué, *La Planète Financière,* Armand Colin, 2015

Henri Bourguignat, *Les Vertiges de la Finance International,* Economica, 1987

Nicholas Shaxson, *The Finance Curse,* Bodley Head, 2018

FIGURES

Table 1: *Sectoral Components of value-added (%) Singapore and South Korea* Sources: World Bank, OECD

Table 2: *Sectoral Components of value-added (%) Singapore and South Korea* Sources: World Bank, OECD