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ROLE OF FINANCIAL GLOBALIZATION IN THE GLOBAL FINANCIAL CRISIS

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Özet

Ülkelerdeki ekonomik büyüme ve gelir artışı nüfus grupları arasında eşit oranda paylaşılmamaktadır. Gelir dağılımından düşük pay alanların oranındaki artış, ülkenin gelişme sürecinde sağlık, eğitim, beslenme ve barınma gibi temel hizmetlerden yararlananları ve buna bağlı ülke gelişimini olumsuz etkilemektedir. Bu çalışmada, TÜİK tarafından hazırlanan "Gelir ve Yaşam Koşulları Araştırmaları" verileri kullanılarak yıllar içinde Türkiye'de gelir dağılımı karşılaştırmalı analizi yapılmıştır. 1960'lı yıllardan başlayan istatistiki gelir dağılımı verileri, gelir eşitsizliğinde bir iyileşmeyi gösterse bile, en yüksek ve en düşük gelir grupları arasındaki büyük uçurum devam etmektedir. Bu durum gelir eşitsizliğini gidermeye yönelik sosyal politikaların yetersizliğini de göstermektedir. Araştırmada kullanılan veri setinin kapsadığı dönemin içinde kalan 2008 Global krizinin bu eşitsizlik üzerindeki etkisi de gözlenmektedir.

Anahtar Kelimeler: Gelir Dağılımı, %20'lik nüfus dilimleri, Gelir Eşitsizliği, Fonksiyonel Gelir Dağılımı
JEL Sınıflandırması: B41, D31, I32, J31

Income Distribution Problem in Turkish Economy

Abstract

Income and economic growth has not been shared equally by population sub-groups in a lot of countries. Increase in low income groups will effect beneficiaries for country's basic services such as health, education, food and housing. These will also affect country's development effort negatively. In this study, a comparative analysis has done for annual income distribution differences in Turkey by using "Income and Living Conditions Survey" collected by Turkish Statistical Agency. Even though statistical data, started from 1960's, shows that income inequality has been getting better off over time, the gap between the highest income quintile and the lowest income quintile are still very big. 2008 global crisis, which covers time period of the study, has been reflected worsening effect on country's income inequality.

Keywords: Income distribution, 20% of population quintiles, Income Inequality, Functional Income distribution.
JEL Classification: B41, D31, I32, J31

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1. Introduction

The accelerating financial globalization together with financial liberalization and deregulation as of 1980s has increased both volatility in the financial markets globally and frequency and severity of financial crises. The frequency of financial crises has increased two fold relative to periods of the Bretton Woods and Gold Standard since 1973 (Bordo et al., 2001:54). The global financial crisis broke out in September 2008 as a result of subprime mortgage crisis arising from the outburst of speculative bubble which grew up in the United States (US) housing market between 1997 and 2006 (Shiller, 2008,1). The subprime mortgage crisis of the US turned a global financial crisis through the spreading of securitized US mortgages in the globalized financial markets. This study firstly examines development of financial globalization and then investigates the role of financial globalization in the global financial crisis.

The remainder of the study is as follows. Section 2 examines development of financial globalization and its benefits and costs, Section 3 examines the role of financial globalization in the global financial crisis and Section 4 concludes the study.

2. Financial Globalization in Historical Perspective

Financial globalization is the integration of financial markets of all countries of the world into one (Arestis et al, 2005:507). Financial globalization consists of liberalization of the capital accounts and deregulation of the domestic financial sectors. Integration between domestic and global financial markets occurs as a result of cross border capital flows which include foreign direct investment and purchases of foreign equities and bonds and domestic lenders and borrowers participate in the global markets, and utilize global financial intermediaries for borrowing and lending in a globalized financial world (Das, 2006:1). There have been two major waves of financial globalization in the world in the past 140 years. The first wave of financial globalization occurred in the between 1870 and 1914 during classical gold standard. Foreign investment assets increased 55% of GDP in the major European economies during this period and also London was the center of global capital markets (Obstfeld and Taylor, 2004:25) (Chart 1).

Chart 1: Two Waves of Financial Globalization

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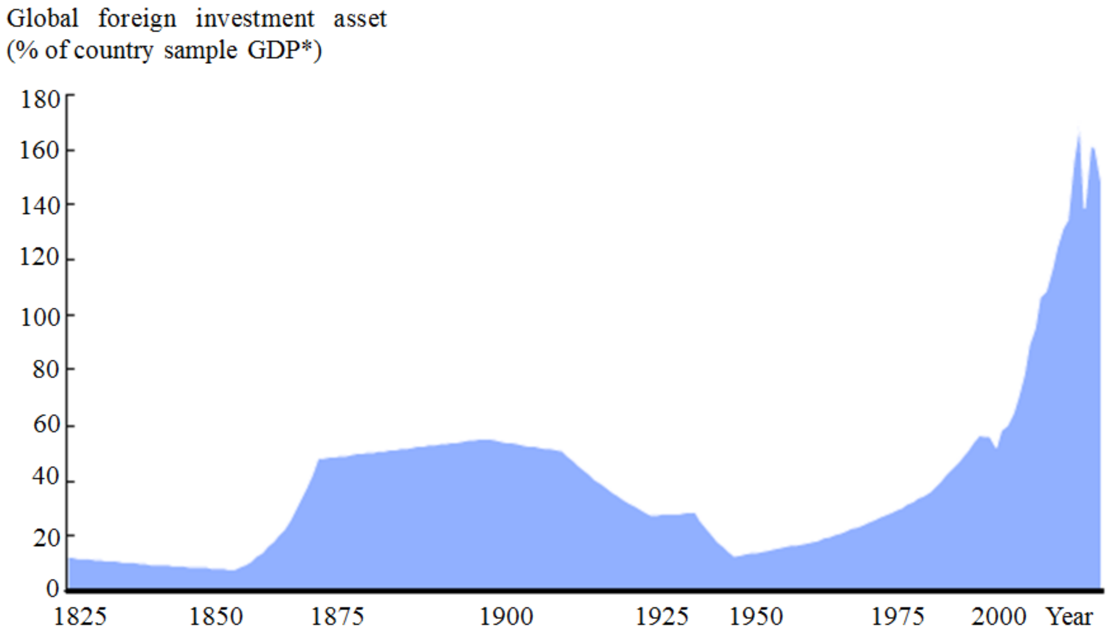
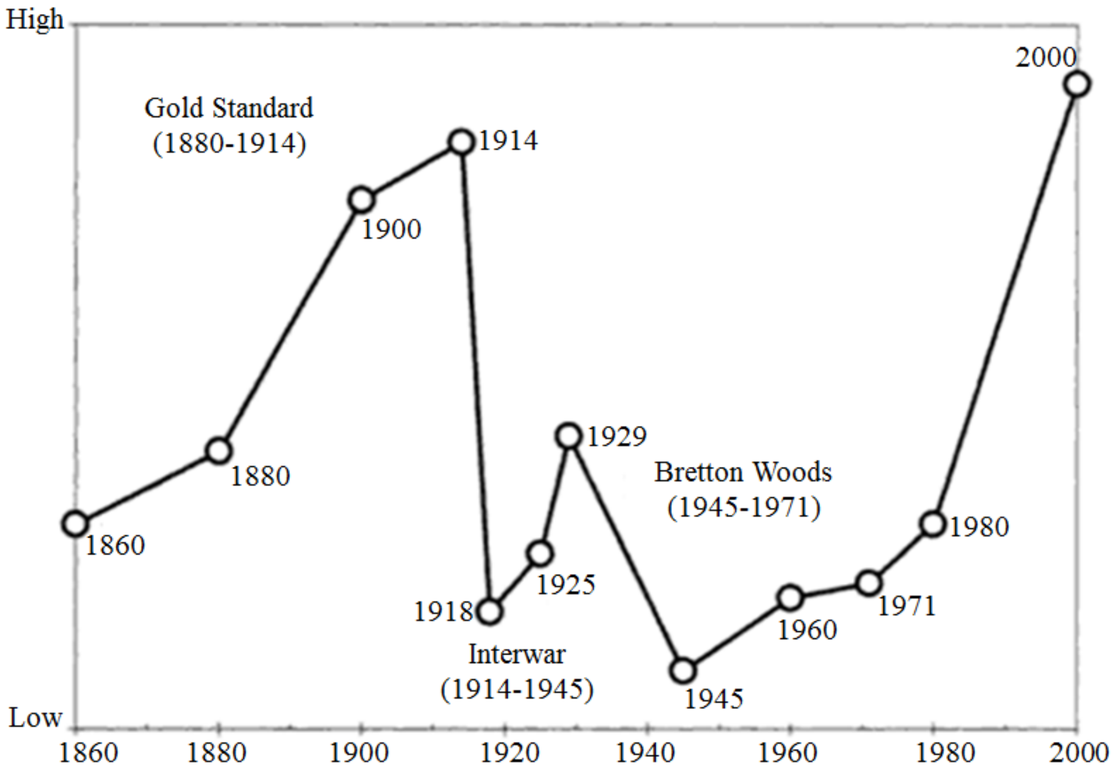


* Country sample includes Canada, France, Germany, Japan, Netherlands, the US, the United Kingdom and other European countries between 1825 and 1938. The sample expands as data becomes available. By 1990, the number of countries increases to 79.

Source: McKinsey Global Institute, 2013:26.

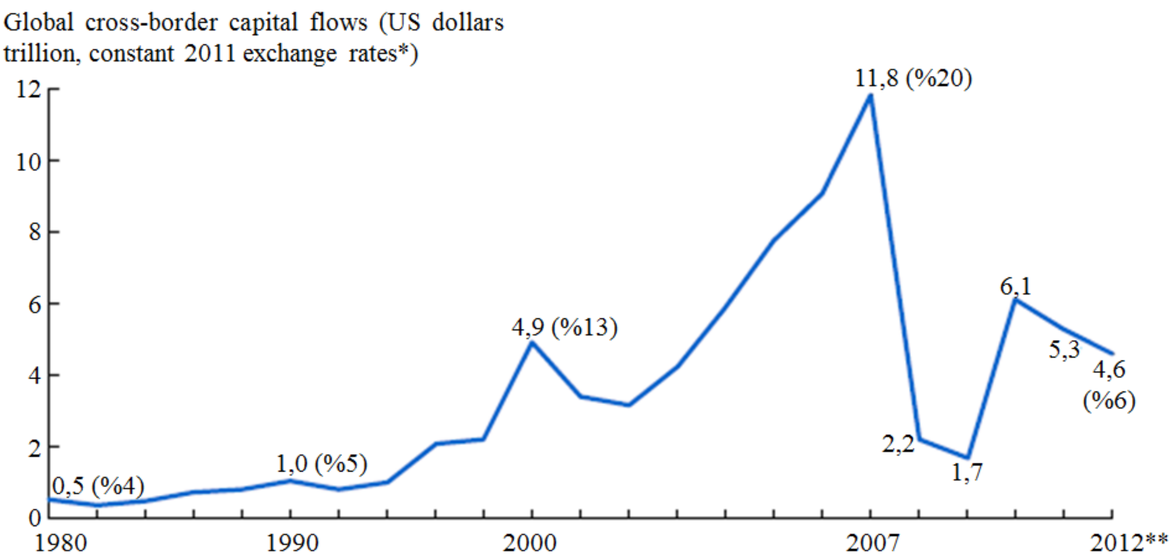
The World War I, the Great Depression and the World War II caused nationalism and non-cooperative economic policies (Obstfeld and Taylor, 2004:25). Cross border capital flows thus brought to a halt between 1914 and 1945. The Bretton Woods system in which member countries fixed their exchange rates by tying their currencies to the US dollar was established after the end of World War II. The Bretton Woods system was collapsed in 1971 when the US suspended the US dollar's convertibility into gold. When the attempts to revive the fixed exchange rates failed, major countries began to float against each other as of 1973 (IMF, 2013) (Figure 1). Although there was an upward trend in the global cross border capital flows as of 1950s, global cross border capital flows accelerated between 1980 and 2007. There was acceleration in two periods respectively mid-1990s-2000 and 2002-2007. The cross-border capital flows increased from US$0.5 trillion in 1980 to US$11.8 trillion in 2007. The global cross border capital flows have contracted substantially with negative effects of global financial crisis and the Eurozone sovereign debt crisis since end of 2007 and they decreased 60% below 2007 peak (Chart 2).

Figure 1: Capital Mobility in Modern History



Source: Obstfeld & Taylor, 2004:28

Chart 2: Global Cross-Border Capital Flows (1980-2012)*



* Includes foreign direct investments, foreign bonds and equities and cross-border loans and deposits and the values in parentheses are in terms of percent of global GDP

** Estimate value.

Source: McKinsey Global Institute, 2013:4.

The institutional and individual investors contributed to the globalization of financial markets. Floating rate of exchange enabled governments to liberalize capital flows with the collapse of Bretton Woods system, thus contributed to the significant increases in cross border capital flows since 1970s (Das, 2006:2). Moreover the liberalization of the regulatory systems in developing countries led the international firms to participate in local markets. Firms and households have contributed to the financial globalization by borrowing and lending abroad. International investors diversified their cross country risks through financial globalization. The advances in information and communication technology and computer-based technologies also reduced the cost of communications and eliminated the boundaries among countries and thus allowed international corporations to service several markets. Moreover, the increasing competition in developed countries has caused banks and other non-bank financial firms to look for new businesses and markets (Schmukler, 2011:104).

It became possible for anybody to trade in any financial markets in the world, when countries began to liberalize and deregulate financial markets since 1970s. Trading of financial instruments in any financial markets in the world also enabled the risks related to the financial instruments to be exported. Moreover some banks also became globalized during the globalization (Huwart and Loïc, 2013:131).

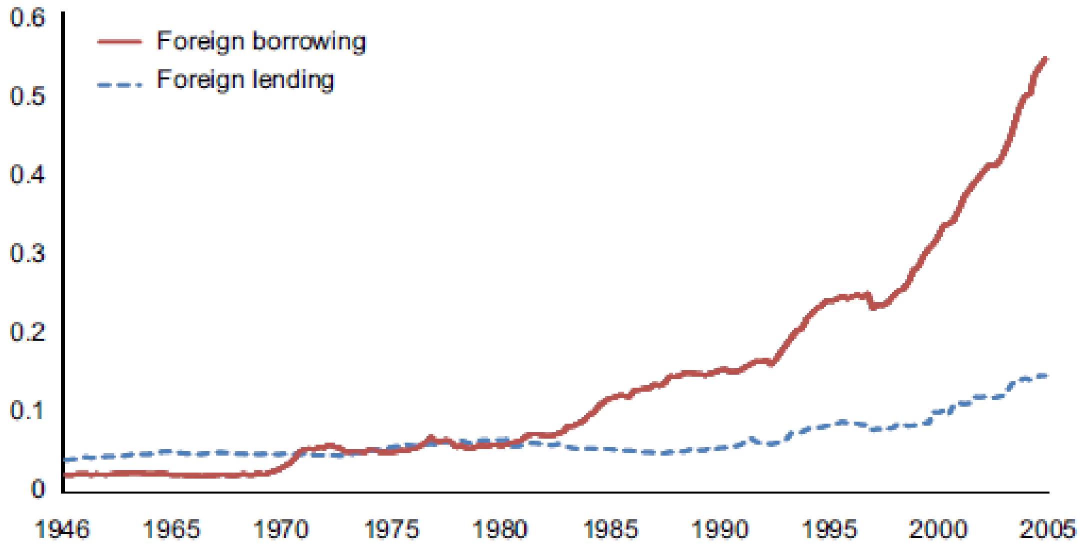
Financial globalization has positive and negative effects on the developed and developing countries, but the studies in the literature generally have examined the effects of financial globalization on the developing countries. The potential benefits of financial globalization are international risk sharing for consumption smoothing, the positive impact of capital flows on domestic investment and growth, enhanced macroeconomic discipline, and development of financial system. On the other hand the potential costs of financial globalization are concentration of capital flows and lack of access, domestic misallocation of capital flows, loss of macroeconomic stability, pro-cyclicality of short-term flows, herding, contagion and volatility of capital flows. (Agénor, 2003) (See also Prasad et al. (2003), Schmukler (2004), Mishkin (2005)). Both the developed countries and the developing countries could take advantage of benefits of financial globalization. However the developed countries gained more benefits due to their advantages such as technology, education, finance and management (Zhang, and London, 2011).

3. Role of Financial Globalization in the Global Financial Crisis

The outburst of speculative bubble which grew up in the US housing market between 1997 and 2006 caused to increase especially the delinquency rate of subprime mortgages together with increasing Fed funds rate and slowdown and decline of house price appreciation (Mayer et al., 2008:2). The US subprime mortgage crisis broke out due to increases in delinquencies and foreclosures of subprime mortgage and thus losses in the securities backed by subprime mortgages in August 2007. The US housing finance system shifted from the traditional originate-to-hold model to capital markets based funding as of 1970s. This change in the housing finance system of the US enabled originators to sell their mortgages Government sponsored enterprises Fannie Mae and Freddie Mac and the other financial institutions which bundled them into pools, and issued mortgage backed securities (Financial Crisis Inquiry Commission, 2010:3-5). Because the subprime mortgages were packaged and sold to investors in many countries, risk of mortgage backed securities also was spread in the global financial markets. The collapse of Lehman Brothers which was the fourth-largest investment bank of the US, and the American International Group turned the US-based subprime crisis into a global financial crisis in September 2008 (Mishkin, 2011:52). The subprime mortgage crisis turned the global financial crisis with effect of the global proliferation of securitized, toxic US subprime mortgages (Greenspan, 2010:202).

Financial globalization had influence in emergence and spread of global financial crisis through two channels. Firstly foreign institutional and individual investors, especially European banks, took part in rapidly expanding asset backed securities markets of the US which were at the center of global financial crisis. So a large fraction of the credit expansion in the US economy was financed by foreign borrowing and the net credit assets held by the rest of the world against the US increased 50% of the US GDP since 1982 (Mendoza and Quadrini, 2010:26). Secondly since some financial institutions began to operate globally together with the financial globalization, the size and complexity of these banks increased. Increasing size, complexity and variety of financial instruments made difficult for the national regulators to regulate and supervise global banks (Lane, 2012:8). On the other hand international regulations for the banks and financial institutions also fell behind financial innovations in the global financial market.

Chart 3: Foreign Credit Market Borrowing and Lending in the US (Fraction of GDP)



Source: Mendoza and Quadrini, 2010:25.

Financial globalization enabled institutional and individual investors to invest in foreign securities in a globalized financial system and financial markets became integrated and interconnected. So a serious problem in the financial system of one country has potential to affect the global financial system negatively. Global financial crisis mainly arose from the US subprime crisis. Many foreign financial institutions and investors bought financial assets based on the subprime mortgages, so subprime crisis turned into global financial crisis when subprime mortgage borrowers began to default on their payments, there were considerable decreases in value of mortgage backed securities and mortgage-related assets became toxic in a short time and their effects spread worldwide creating a credit freeze. Many financial institutions had about US$732,9 billion in asset write downs, European banks reported about US$294 billion in losses due to toxic assets (Yap and Pierson, 2008). So the US based crisis was thus transmitted to the rest of the world through cross-country banking linkages arising from financial globalization (Kollmann and Malherbe, 2010:2).

Table 1: Losses of Major European Banks (US billion dollars)

Country	Banks	Losses
The United Kingdom	Royal Bank of Scotland	15.6
	HBOS	9.5
	Barclays	6.7
Switzerland	UBS	48.6
	Credit Suisse	13.7
Germany	BayernLB	14.4
	IKB Deutsche Industriebank	14.0
	Deutsche Bank	12.7
France	BNP Paribas	5.8

Source: Yap and Pierson, 2008

Financial globalization also affected crisis management in many respects. The high levels of cross-border financial positions and the volatility in cross border capital flows and inadequacy of international regulation on over growing and expanding international financial institutions which may pose a risk for the global financial system constrained national governments to combat with the global financial crisis (Lane, 2012:9-10). Because countries could not recover from financial crisis only with their individual measures, this makes international cooperation mandatory against crises.

4. Conclusion

There have been two major waves of financial globalization in the world in the past 140 years. The first wave of financial globalization occurred in the between 1870 and 1914 and the second wave of financial globalization began in 1950s and has accelerated due to financial liberalization and deregulation, advances in information and communication technology and computer-based technologies since 1980 and the cross-border capital flows increased from US$0.5 trillion in 1980 to US$11.8 trillion in 2007 and has begun to decrease as of 2007 with the negative effects of global financial crisis and the ongoing Eurozone sovereign debt crisis. The financial globalization has positive and negative effects both on the developed and the developing countries. While financial globalization has benefits such as international risk sharing for consumption smoothing, the positive impact of capital flows on domestic investment and growth, enhanced macroeconomic discipline, and development of financial system, it has also costs such as concentration of capital flows and lack of access, domestic misallocation of capital flows, loss of macroeconomic stability, pro-cyclicality of short-term flows, herding, contagion and volatility of capital.

The financial globalization played a key role in emergence and spread of global financial crisis. On the one hand many foreign institutional and individual investors made investments in the rapidly expanding US mortgage backed securities markets, which were at the center of global financial crisis and thus they imported risk from the US markets. On the other hand national and international regulations remained incapable in auditing financial institutions of which their size and complexities were growing rapidly due to increasing international transactions as a result of financial globalization. Consequently global financial crisis emerged and spread through the global proliferation of securitized, toxic US subprime mortgages in the global financial markets and the inadequate national and international regulation. Moreover financial globalization also reduced the impact of national measures to combat with the global financial crisis due to high levels of cross border financial positions and the volatility in cross border capital flows and inadequacy of international regulation on over growing and expanding international financial institutions.

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