# THE GLOBAL FINANCIAL SYSTEM

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Globalisation represents one of the most dominant trends in today's social and economic international relations. Besides affecting the world economy and the entities operating within it, globalisation has, of course, a noticeable effect in the social and political context. The results of globalisation processes are not restricted to economic growth and the advance of the world economy, but also include the emergence of new problems, conflicts and disputes that did not appear in regard to strictly divided national and economic areas. Society should therefore understand how globalisation affects particular aspects of the life of countries and their people, and should accentuate the positives, eliminate the negatives and minimise the risks.

Globalising trends are probably most apparent in international financial markets. This process took on a particular intensity in the final years of the last century, mainly due to liberalisation and deregulation of economic processes, supported by the considerable scientific and technical advances in the area of information and communication technologies.

The international movement of capital has risen in value over the past twenty-five years by more than thirtyfold. The largest share of this growth is accounted for by the increase in volume of portfolio investments, especially shares, as well as by growth in foreign direct investment. Nevertheless, the international trade in goods and services has seen turnover rise by "only" 320% during the same period, while world gross domestic product has grown by 140%. It is clearly a long time since international capital flows were linked solely to the international trade in goods and services, and they are in fact forming a more or less independent market. International financial markets are gradually gaining independence and are to an increasing extent outside national management and control. Their effect, however, on the national economy remains considerable.

During the 1990s, the world experienced a number of major financial crises that adversely affected the life of many people, and not only those in the afflicted countries. Since it was not possible to be reconciled with the fact that financial crises are a necessary price for the integration of economies into international financial structures, an intensive discussion began across the world on the functioning and direction of international financial markets and on whether their structures included serious problems and failings that brought on these crises.

There started to be talk of "a new architecture" for financial markets. This includes the main changes proposed within the existing financial system to avert a repeat crisis situation, in other words to prevent the emergence of financial crises. The measures may be divided into three groups: measures to restrict the excessive inflow or outflow of capital, measures to make the private sector more engaged in addressing financial crises, and measures to reform the public sector and the public institutions operating above the international financial market. Within each group there are many proposed measures, some of which are more realistic than others and all of which have their proponents and opponents.

In is not realistic to expect that a dramatic and fast change in the functioning of the international financial system will happen in the near future. Nor can it be expected that the trend of liberalisation and deregulation in international capital flows will be stopped or reversed. It should be realised that the trend of gradual liberalisation in the movement of international capital is currently driven by something much stronger than simply "free market" ideology, i.e. technological progress, which makes the effective control of this movement ever more costly and less effective. It is also obvious that as more countries liberalise the movement of international capital, so it will be more difficult for other countries to restrict it.

Is it good for countries to deregulate and liberalise financial transactions and thus become more integrated into global financial structures?

The prevalent consensus among economists is that a developed financial system benefits a country's economic growth. This happens mainly through its positive effect on capital accumulation and technological progress, and therefore also on the labour productivity of economic entities. This general consensus is not, however, to be seen on the issue of the liberalisation of national financial systems and their integration into the global financial system, and on the effect of these factors on national economic development.

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Most economist concur that to open up the financial system of a country and link it more efficiently with the financial systems of other countries, in other words the global financial system, make that country's financial system function more effectively. Liberalisation and subsequent integration improve the capacity to manage and diversify risks and make the global allocation of capital and investments more efficient; integration also forces greater discipline on national institutions responsible for macroeconomic policy. On the other hand, opponents of financial system liberalisation point out that whatever advantages come out of liberalisation are offset by the volatility of growth and the risk of economic crises that liberalisation carries with it, and that economies become far more vulnerable to sudden and economically-destabilising capital outflow.

### Does a country benefit from financial liberalisation?

In examining how a country's integration into international financial structures affects its real economy, it is appropriate to examine the development of the main microeconomic indicators. By analysing the relationship between the intensity of a country's financial integration and the growth of its GDP, we find that the country's integration into the global financial system is not a decisive factor of economic growth, although it may in certain circumstances have an indirectly positive effect on growth. This means that financial integration does not in itself ensure economic growth.

Taking a similar approach, it is possible to see how a country's financial integration may affect the volatility of its economic development. The results indicate that countries which are more integrated have more stable economic growth compared with countries which are less integrated or not integrated at all. This to some extent confutes the prevailing view that financial integration of a country has a negative effect on its GDP growth stability. Although it is the case with open economies that any financial crisis adversely affects the swings of their economic development, this risk is usually offset by the more stable long-term growth brought about by the economy's financial integration. One reason for this could be that government institutions produce better, more consistent and more suitable macroeconomic policy when under danger of provoking an actual economic crisis.

The assertion that economic policy is improving in quality may also be confirmed by examining the relationship between a country's financial integration and its level of inflation. The results show that countries which are more financially integrated have lower inflation than do those which are less integrated.

Using a similar analysis, it is possible to prove the claim that short forms of capital investment into liberalised countries are growing substantially. Examinations show that financially integrated countries are receiving greater volumes of short-term and long-terms capital and also that capital structure has been altered by the effect of integration in favour of its short-term form.

These results confirm that the benefits of financial integration far outweigh the negative effects, or risks, even if it is not directly connected with national economic growth. As a result of financial integration, there is obviously less scope for the state to conduct an active financial policy for the management of the domestic economy. International capital flows thus squeeze the space in which economic policy can be executed, while their effect substantially accelerates its consequences. Relatively small measures of economic policy can thus have a substantial impact on the overall economy. The main contribution of a country's financial integration should probably be seen in the growth in effectiveness. Indeed, financial integration compels state institutions, especially governments and central banks, to conduct economic policy in a better and more consistent way. Considered and effective economic policy is also the basis for efficiently exploiting the potential of integration in the international financial system and for taking advantage of the potential of instruments and functions of the financial market. It is at the same time the main prerequisite for staving off financial crises.

During the period before complete liberalisation of international capital flows, a country should ensure that it is well prepared for this step. Most crucial in this regard is the preparedness of the domestic financial sector. It is particularly important to have consistent risk management, as well as transparency of financial flows, legal structures for property, and last but not least a sufficient volume of reserves and capital for the coverage of any risks. On the other hand, the national economy is exposed to an increased risk of financial crisis. Other factors are, of course, also important for a country's general economic environment, and include the level of development in the institutional environment, the state of the legal environment and court system, the enforceability of rights, legal protection for creditors, the standard of the education system and the education level of the population, as well as many other factors. Their level to a great extent codetermines the intensity and benefit of financial liberalisation.

This also means that the functioning and resilience of the international financial system as such is determined above all by the condition of the national financial systems of individual countries. Like the proverbial chain, it is only as strong as its weakest link. That is why future efforts to improve and strengthen the international financial system should not be made through the introduction of regulatory measures or other restrictions, but should rather focus on the qualitative level of individual national financial systems, and above all on strengthening the consistent and internationally-coordinated supervision of the whole financial market and its institutions. The main features should include securing the environment, establishing rules and a consistent supervision focused on the identification and spreading of risks, ensuring sufficient reserves and capital, ensuring transparency in property relations and in stock market transactions, ensuring transparency and stable rules for accountancy and auditing as well as their consistent control, providing effective procedures for bankruptcy and settlement, and ensuring personal responsibility in corporate governance. An effective and consistently managed national financial system may, with the assistance of the above, curb to a great extent the risks linked to financial integration and maximise the advantages of international capital flows.

In Slovakia, too, a step in the right direction is being taken in this regard with the planned application of capital adequacy management for banks in accordance with the new criteria of Basel II. This brings a much more sensitive approach to the assessment of risks related to banking business and also introduces a new form of risk – operational risk. Nor to be forgotten are the similar measures – Solvency 2 – being prepared in the insurance industry, and the unification of financial market supervision under the authority of the National Bank of Slovakia.