# Market Globalization and the Stability of Financial and Credit Sectors

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Economic globalization and financial market stability are issues that economists have been analysing, market operators dealing with, and governments issuing decisions upon for a long time.

Much has been said and written about them. Articles by authorities on the subject have been published in *Moneta e Credito* and the *BNL Quarterly Review*, and the subject has wisely been chosen to celebrate the 50th anniversary of both these journals, which I am delighted to be able to attend.

The topical relevance of this whole issue has been confirmed by the recent turmoil on the world's stock exchanges, prompting us to reflect on the interplay between globalization and finance, which not only offers many opportunities but is also fraught with risk.

In my paper, I shall firstly mention a few general facts as the framework for the debate, and then examine the linkage between globalization and financial market stability with specific reference to the strengthening of Italy's financial infrastructures, and conclude by addressing the importance of European economic and monetary union within the world context.

A global economy may be defined as an environment in which the free flow of resources is not hampered by national borders. It does not exclude – indeed it demands – both rules and the parallel consolidation of infrastructure that can underpin the operation and stability of the worldwide common market.

The lack of barriers and harmonization of the rules create the possibility, in this ideal world, to establish a broader international division of labour and guarantee more efficient allocation of savings. The enlargement of markets and the spread of technological progress

☐ Minister for Treasury, Budget and Economic Planning, Roma (Italy).

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increase productivity, while helping to bring about a general improvement in people's living standards.

The whole globalization model hinges around competition between companies and between the financial institutions operating on a transnational scale. Governments are no longer required to act as entrepreneurs, but as guides, arbiters and regulators, as I recently wrote in an article in *BNL Quarterly Review* (June 1996).

So much for theory. However, the real world only partly follows the features of the model I have tried to sketch out. In practice, the state of globalization reflects the increasing economic interdependence achieved over the past twenty years thanks to three main factors: increased trade, increase in international capital flows, particularly short-term, and the rapid and widespread dissemination of technological innovation, especially in the fields of IT and telecommunications.

Between the mid-Seventies and the mid-Nineties, exported goods and services as a proportion of gross world product rose from 12 to 17 per cent. Over the same period average daily trading on the international currency market rose from 15 billion to 1,300 billion dollars. The annual flow of direct inward foreign investment has risen from 28 to 318 billion dollars. The unit cost of data processing has fallen 100-fold, and the price of an intercontinental telephone call has decreased 10-fold.

Yet globalization has not prevented a further widening of the wealth gap between North and South. In 1965 average per capita income in the G7 countries was 20 times above that of the seven poorest nations in the world, and in the 30 years since then it has doubled from 20 to 39 times.

Globalization has been through a number of critical moments, particularly in the emerging economies which have succeeded in narrowing the gap between themselves and the wealthier countries. A case in point are the Asian countries, whose fragile financial and banking infrastructures made the massive inflow of financial resources from abroad both a source of development and a cause of risks, including systemic risks.

Faced with these contrasting elements, I must leave it to the distinguished scholars who will be speaking after me to try to judge the current state and future scenario of globalization.



Looking back to the past I cannot fail to call to mind the lessons to be drawn from the important experience of globalization between the mid-19th century and the outbreak of the First World War. Then, as now, trade expanded and international financial flows grew thanks to the gradual lowering of tariff barriers and the removal of administrative constraints, which was backed by currency stability guaranteed by the gold standard.

Then, as now, greater economic and financial interdependence was helped by the widespread dissemination of major technological innovation in the field of transport and communications. I am thinking of the construction of the vast railway networks, the use of steamships and the introduction of the telegraph and telephone.

The economic effects of this first globalization were considerable. One only has to recall that exports as a proportion of gross world product peaked in 1913 at a level that was not reached again for another 70 years, in 1970. For a great many countries in Europe and North America the real annual development rate settled around three per cent throughout the whole period from 1850 until the eve of the First World War.

Despite the formidable performance achieved by the world economy as a whole, however, greater integration and opening-up of the markets did not mean a balanced distribution of the revenues and costs of globalization. This led the countries damaged by it, particularly the ones which caught up late with the industrial revolution, to advocate a return to protectionism. The voice of the discontented was heeded, and became a perverse instrument in the hands of the new Leviathans who pushed the world, and particularly our own Europe, to the most horrific war the world has ever known.

Fortunately, the risks confronting us today are not so dramatic. Even so, the lesson we have to learn from history must remind us that when globalization shortens the times and distances of the economy and finance, the real danger lies in delay in adjusting infrastructures and in coming up with a political response.

We must therefore gear the organization and the rules of the market, endeavouring primarily to shore up the stability of the financial circuits. What is vitally important is the capacity of the governing class and society as a whole to take up the challenges of global competition in the fields of research, flexibility and efficiency, and to do so in a balanced but also determined manner.

I would like to dwell on these points, and make a few specific references to the Italian case.

As far as the financial markets are concerned, the explosion of globalization is reviving the threat of systemic risks. People are afraid of the contagion that might break out in some distant part of the globe and rapidly spread, threatening the stability of whole economies.

Drawing once again on the lessons of history, we cannot fail to see that financial fads and speculative pipe-dreams are by means the privilege or novelty of our age. As Charles Kindleberger rightly said, the financial crisis is an 'evergreen'.

What is, however, typical of today's financial globalization is perhaps the risk that the seeds of instability might lurk in delays – proving inconsistencies and weaknesses – in responding to political and functional innovations on the part of organizational and institutional infrastructures.

In a financial world in which the political and administrative borders are tending to disappear, the fragmentation of prudential supervision is reducing its effectiveness and creating dangerous concentrations of risk in areas where control is less stringently applied. The uncertainties are often aggravated by inadequate cooperation between the various authorities and by failure to enforce the rules properly.

A joint coordination effort has been undertaken at the international level to try to overcome these difficulties and remove the inconsistencies. Following the guidelines drawn up by the G7 Summits in Halifax and Lyon, the aim of improving cooperation between the supervisory authorities of the banks and securities markets is being pursued on the basis of the fundamental principles of protecting competition, guaranteeing transparency and simplifying and consolidating the rules.

A great deal has been achieved over the past 15 years in terms of bank supervision, particularly as a result of the work of the Basle Committee. International cooperation in regulating financial services is a more recent, and hence less advanced, development in this direction.

The same principles – competition, transparency and simplification – lie behind the commitment we are currently pursuing to give Italy new, truly modern rules of corporate governance.



As I recently had occasion to point out, the corporate governance system based mainly on public ownership, or on family and fiduciary relations and alliances, has dominated Italy's economic history. In the past it has given positive results in terms of industrial development, but for some time now it has been showing its limitations.

While the group structures that have emerged based on State or family capitalism have made growth possible in terms of dimensions, they have created serious difficulties in terms of minority shareholder protection, and aggravated the problem of conflicts of interest and shortcomings in the degree and quality of public disclosure.

This being so, the drafting of a new charter of corporate rights marks the necessary completion of the reform of financial brokerage firms and the markets introduced in Italy through the Consolidated Bank Act and the Eurosim Decree.

Reform of financial brokerage firms, markets and listed companies is the cornerstone for a new and organic regulatory infrastructure. It constitutes the basis of a single design aimed at giving the Italian stock exchange system a status which will enable it to cope with the challenges of the globalization of financial flows, the rapid growth of private equity investment, and the imminent adoption of the European single currency.

Adjusting the infrastructure – and primarily that of the financial markets – cannot in itself be considered sufficient to guarantee a smooth passage across the vast sea of globalization.

In addition to having a solid ship it is necessary to know how to govern it, how to choose the right route, and then to continue along that route perseveringly. For Italy, the right route to beat the challenges raised by globalization is the one that is leading us towards the European single currency.

Just over a year ago, Italy was faced with a very difficult choice. The economy was stagnating. And even though inflation was falling, it still remained at twice the European average. Despite improvements, the public sector deficit stayed around 7 per cent of GDP. All this meant that Italy was excluded from joining the European Monetary Union.

In that far from easy situation, the Italian government decided to hasten the pace towards the euro. Joining EMU in the first wave

has become the spearhead objective of our policy. It was not only an economic decision, however. Monetary and economic union is a historic opportunity.

And the choice that we made has been rewarding. In just over one year the country has made progress that most people thought impossible. Inflation has been brought down; the lira has rejoined the European Exchange Rate Agreement; the public deficit has been reduced to an exceptionally low level; a very substantial current account surplus in the balance of payments has been consolidated; reduction in the burden of the public debt on the economy is now an established fact; and all this has been the result of an economic policy which has won the appreciation of the financial markets, narrowing the gap between the yields of Italian medium-term securities to within just a few thousandths of Europe's benchmark rates.

It is no coincidence that in the recent period of violent upheavals in the world stock exchanges, this renewed confidence in Italy has not wavered, and this has been encouraging.

In addition to these comforting signals there are also increasingly evident indications that Italy is entering a non-inflationary period of economic recovery. That Italy has successfully rebalanced the public accounts and simultaneously staged economic recovery is now statistically proven.

It might be interesting to debate the way in which the inevitably restrictive effect of rebalancing the public accounts on the global demand has been offset by the fall in interest rates and the increased availability of resources, which has benefited the productive economy as a result of the lower takeup of savings by the public sector. It is a virtuous circle parallel to that generated in the public accounts, with a higher primary surplus and lower debt interest burden, which made it possible to cut back the overall deficit from 7 to 3 per cent of GDP in the space of a single year. Current trends in Italy confirm the view that rigorous and credible fiscal adjustment policies can lead to economic expansion.

It is against this background that Italy is being called upon to complete the final leg to the inauguration of the euro.

The common currency to be heralded in next spring will be a 'broadly-based' euro, with many countries able to join in the first wave. A currency representing all the diversity of Europe, in all its complexity, but one which unites the Central European, the Nordic and the Mediterranean components.



It will be a 'strong' euro, based on the strength of an economically and institutionally cohesive Europe, but not a composite euro-currency, an average between the 'weak' and the 'strong'. The stringent path of convergence has had far-reaching effects; conditions of stability have become entrenched, and have become our common asset.

Precisely because we are anxious to see a strong and broadly-based euro of this kind, we know that the last phase along the path will not be easy. We also know that once next spring's evaluation has been carried out successfully, the European single currency will impose tough constraints on the participating countries. In particular, within the European Union it will no longer be possible to introduce adjustments by changing the parities of national currencies, and individual countries will need to have greater margins of flexibility in the use of their factors of production, or they will lose out seriously in terms of growth and employment.

But we also know that the progress that Italy has made so far is not a passing phase, and that the culture of stability is now firmly rooted in the conduct and thinking of Italy's business community; and we also know that the process of reducing the public deficit is being consolidated through the reforms which Parliament and government have now introduced. The structure of Italy's productive economy is competitive, and its growth potential is strong precisely because, more than in any other European country, it is underpinned by a wide range of small and medium enterprises in virtually every part of the country.

This being so, monetary union is an opportunity and a stimulus to promote greater competitiveness, to halt and indeed reverse the back-stepping that has penalized Europe for over 15 years in competing against the other major areas of the world.

In the globalization model, the creation of the euro is an element of simplification and stability. The euro will make a positive contribution to international equilibria to the extent that it manages to represent an area and a market redistributing capital and labour within to an optimal degree, drawing on and exploiting traditions and vocations in a dynamic and competitive equilibrium. United Europe is deeply rooted in the awareness of all, in the common history that we share as European citizens.