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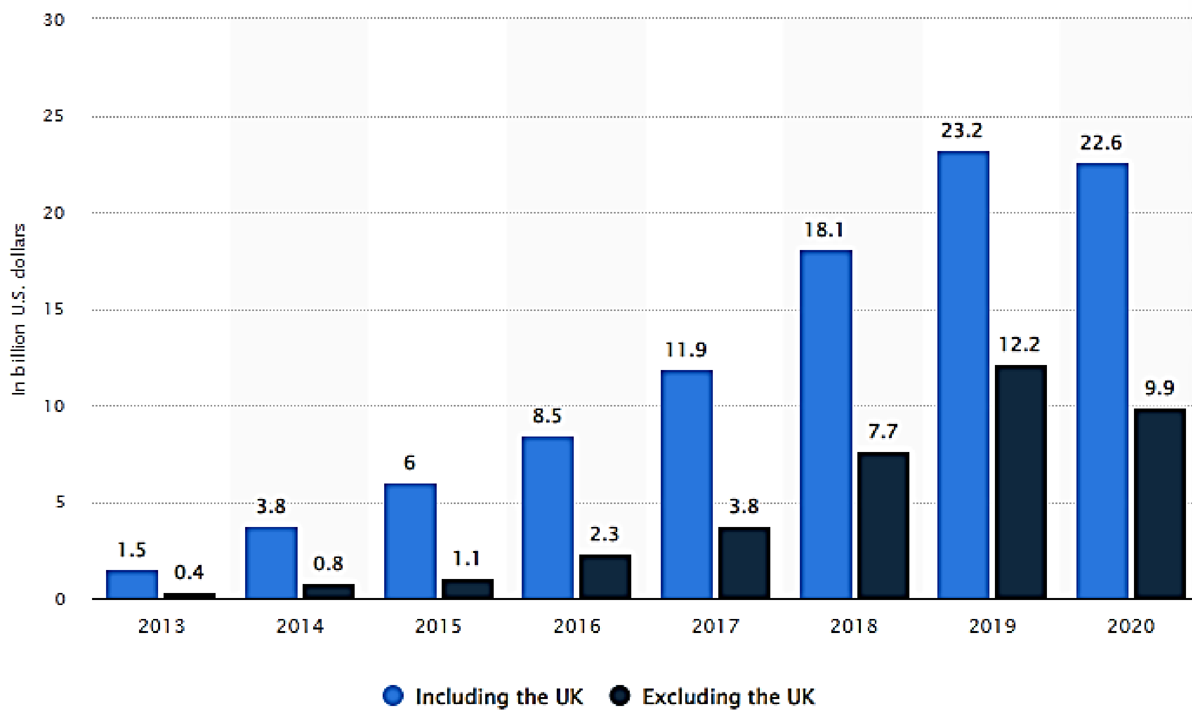
The Globalization of the Financial System

Global cross-border financial flows have grown steadily in recent decades due to increased globalization. For starters, several financial organizations, such as banks and institutional investors, have broadened their global scope. First, they functioned as an intermediator to transfer money from lenders to borrowers on the other side of the world. Second, as the markets have matured, they have developed a distinct cross-border focus. International investors are often targeted when new securities are created and made available for sale to the public. Third, these changes have liberalized cross-border financial flows and national financial markets during the past few decades. As a result, economic agents worldwide now have more options for borrowing and lending money. As a result, the financial possibilities for financing macroeconomic imbalances and recycling current account surpluses have expanded significantly. Fourth, technology advancements and financial innovation have considerably influenced the globalization of financial markets in recent decades. Systems for storing and processing vast amounts of data have improved dramatically during the last few decades. The implications of telecommunications networks have expanded, and their capacity has increased, making it possible to communicate and trade more efficiently. When it comes to doing business across borders, the distance barrier has been significantly lowered by making it easier and more secure. The effect of globalization on the financial markets is particularly obvious in the case of

the US or European financial markets. The paper discusses the nature and the scope of the interaction of the U.S and the European financial system with the global market.

The world's largest and most liquid financial markets are in the United States. Moreover, amounting to $1.5 trillion, finance and insurance accounted for 7.4% of the United States GDP in 2018. Furthermore, products and services in the financial sector assist in increasing ease and funding for exporting consumer products and agricultural goods exported from the United States of America. With the exclusion of reinsurance, the United States had an approximate surplus of $40.8 billion in the financial services sector, insurance, and trade in 2017, exporting $114.5 billion worth of financial services. More than 6.3 million individuals worked in the financial services and insurance industries by the end of 2018. In addition, making investments in the American financial sector has major benefits for domestic and global financial institutions. More than two-dozen financial services firms on Fortune's Global 500 list have selected America as their headquarters because of the country's dynamic and competitive financial services industry. As a result, customers have access to the widest range of financial instruments and products available in the market (*SelectUSA*). Similarly, 2013 to 2020 saw a significant rise in Europe's alternative finance market, which includes the UK. The market is expected to grow from $1.55 billion in 2013 to $22.6 billion in 2020.

Size of the European Financial market from 2013-2020



Source: Statista 2022

The financial markets of the US and European region are highly responsive to each other, and any change in one financial market when interacting with the fluctuations in the financial market of the other region results in global financial disturbances and changes. In other words, when one financial market fluctuates, it may have a ripple effect on different markets and cause global financial instability and upheaval because of how closely linked they are. One of the most visible signs of economic globalization is that financial markets are becoming more intertwined. The scope and complexity of global financial integration are still difficult to define, even though it has become a cliché that what occurs in foreign markets affects domestic markets and vice versa. Lozada argues that fluctuations in short-term interest rates in the United States significantly impact euro area bond yields and equities markets, accounting for up to 10% of the entire movement in the euro area bond market (1).

The two economic concepts that could help analyze the interaction of the US and financial system with the global market are:

1) The comparative theory of advantage

The interaction of the US and the European financial markets opens the gates for trade and free mobility of financial assets across borders. Although one nation may manufacture all of its items at a lower cost than another, the principle of comparative advantage holds that both nations can still trade under conditions in which they each profit from the transaction. As result of this idea, it fosters a beneficial relationship between the two financial systems in the issue.

2) Liquidity

Liquidity refers to an asset's capacity to be quickly and readily converted into cash at its current market value without incurring a loss. The more liquid an asset is, the simpler it is to convert into cash. Knowing how quickly a corporation can pay off its short-term responsibilities and debts; therefore, liquidity is a key factor. For Europe's financial system, liquidity is critical because the region has had few severe debt accumulations and crisis events.

SWOT Analysis

Economic resilience, adaptability, and innovation characterize the United States' economy. There were several costly setbacks in the economy in the early 21st century, but the economy recovered. The US financial system has no greater strength than its burgeoning and expanding private sector. The government of the United States has a minimal impact on the day-to-day operations of most of the country's businesses. Businesses are freely allowed to recruit and dismiss people and start and stop operations. Product introductions and new business models may go forward quickly here, unlike in many other nations. Many industries are subject to regulation by the United States government, yet most of the country's economy and financial

markets are managed by its private sector. Governmental institutions, private businesses, and sub-sectors of our economy are examples of these strengths. The Euro is the most important financial variable in the European financial system; since the introduction of the euro, bond and money markets have been widened and integrated ('European Central Bank' 1). The euro is well-positioned to play an even bigger role in the world economy, having a broad economic area, developed financial markets, low currency volatility, and an independent central bank with a clear price stability mission and prohibition of monetizing government deficits.

As a result of the 2008-09 financial crisis, the banking sector, financial system, and mortgage market have all become stronger. Similarly, the coronavirus outbreak is highlighting flaws in several sectors of the economy (Sen 1). Financial markets in America are weakest when they cannot handle a crisis as severe as that of Covid. Taking on too much leverage to boost earnings and shareholder rewards is an error often made by American banks. Banks could generate more money with less equity in growing markets because of thin capital buffers. Those capital buffers, however, proved insufficient to sustain enormous credit losses once the economy plummeted, placing the whole financial system and the wider economy in danger. As far as European financial institutions are concerned, the debt problem is the biggest one. The European sovereign debt crisis was caused by the Eurozone's structural issue and a mix of complicated variables, including the globalization of finance and cheap credit conditions over the 2002–2008 era that promoted high-risk lending and borrowing. Many European countries are still grappling with crippling levels of public debt that necessitate a swift and decisive reaction from the relevant authorities.

Policy

The United States has consistently pursued economic policies that have boosted its global competitiveness and economic development. In Europe, the European Monetary System (EMS) was formed to contain inflation and prevent excessive exchange rate changes between these adjacent countries, making it easier for them to trade products. Since the inadequate and ineffective banking system is the major source of the weakness of the American financial system, the proposed policy would solely focus on improvements in the banking sector. The following points will be incorporated into the proposed policy:

1. First, banks should not be given too much leverage through capital buffers, which they use to boost earnings and shareholder rewards during an economic crisis. Banks could generate more money with less equity in growing markets because of lower capital buffers. Those capital buffers, however, proved insufficient to sustain enormous credit losses once the economy plummeted, placing the whole financial system and the wider economy in danger.
2. Some conventional banking operations were transferred from banks and regulated financial exchanges to nonbank firms with less regulation and little or no collateral, putting the financial system at risk. Financial institutions could not fulfill their obligations during a recession because of a lack of collateral, which sparked concern about whether or not the contracts they had signed could be depended upon.

Policy proposal for European financial system

To combat the debt crisis and buildup in the European region, the following policy implementation steps are proposed:

- More bailout money.
- Improve borrowing options and keep borrowing and lending under control

- Improve the behavior of both borrowers and lenders through increasing responsibility.
- Ensuring maximum private risk-sharing
- Avoidance of financial disintegration
- Remove barriers and restrictions to capital market integration in Europe

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