

Financial Globalization, 1970-2015: Winners and Losers

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Disclaimer: The views expressed herein are solely those of the authors and do not necessarily reflect those of the IMF.

Introduction

- Tremendous rise in cross-border capital flows since 1970
- Reallocation of capital has profound implications for
 - world output
 - the distribution of individuals' income across and within countries

Question:

Who wins and who loses from financial globalization?

This Paper

- ① Start from international investment gravity model (Pellegrino, Spolaore, and Wacziarg, 2021)
- ② Wedge accounting framework to estimate barriers to asset trade since 1970
- ③ Use model to quantify effects of financial globalization on world output, cross section of wages and returns on portfolios

An International Investment Gravity Model

- World: I countries
- Three factors
 - Immobile: labor and natural resources
 - Imperfectly mobile: capital

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⇒ a gravity equation for foreign assets demand

$$\pi_{ijt} = \frac{\underbrace{r_{it}}_{\text{Returns}} \underbrace{k_{it}}_{\text{Size effect}} \underbrace{\exp(\mathbf{d}'_{ij}\beta)}_{\text{Information friction}} \underbrace{\tau_{ijt}}_{\text{Wedges}}}{\sum_{i=1}^I r_{it} k_{it} \exp(\mathbf{d}'_{ij}\beta) \tau_{ijt}}$$

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 - barriers on incoming flows at **destination**
 - barriers on outgoing flows at **origin**
 - Ex: capital controls, dividend taxes, risk of expropriation, ...

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- Identify τ_i^{in} with worldwide capital market clearing

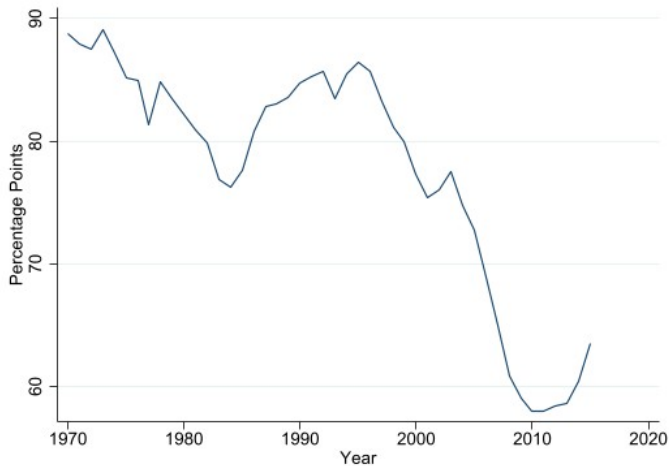
$$\text{External Liability} = \Pi^e (\tau^{\text{in}}) \times \text{External Asset}$$

- Identify τ_j^{out} with domestic share of portfolio π_{jj}

$$\pi_{jj} = \frac{r_j k_j}{r_j k_j + \tau_j^{\text{out}} \cdot \sum_{c \neq j} \tau_c^{\text{in}} r_c k_c \cdot \exp(\mathbf{d}'_{cj} \beta)}.$$

Falling Barriers to Asset Trade and Correlates

- Average implicit tax has fallen



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- Significantly correlates with
 - capital controls (origin, destination)
 - corporate tax (destination)
 - investment safety (destination)

Table

Winners and Losers: Counterfactual

We compare two equilibria:

- with financial globalization: actual barriers
- without financial globalization: barriers fixed at 1970 level

Winners and Losers: Counterfactuals

Financial globalization leads to

(I) Lower world output by 4%

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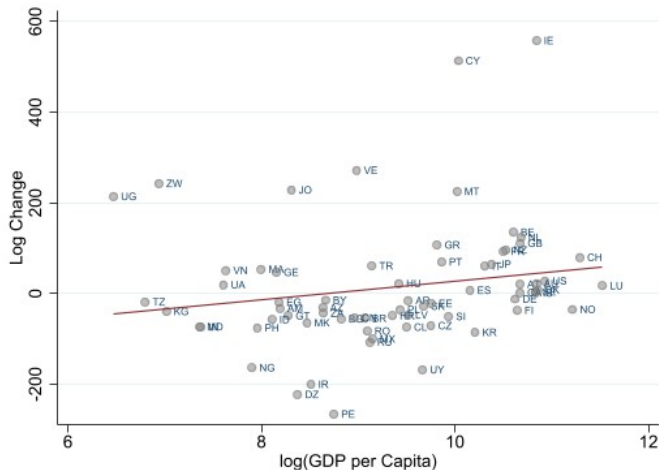
- Capital flow from capital-scarce to capital-rich countries

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(II) Increase in inequality of output per capita across countries

(III) Within high-income countries,

- Wages \uparrow : Influx of capital raises marginal product of labor
- Portfolio returns \downarrow
 - 1 Decline in returns on local assets + Home bias
 - 2 Partially mitigated by diversification of portfolio

Output gains

Openness

Output Capita

Wages

Portfolio

Returns

Conclusion - Contributions

- ① Develop wedge accounting in an international investment gravity model to assess financial globalization
- ② Find that financial globalization has led to lower output, higher inequality across countries, and lower inequality within high-income countries.

Literature

Correlates of Fin. Glob. Wedges [Back](#)

VARIABLES	(1) $\log(\tau_{ij})$	(2) $\log(\tau_{ij})$	(3) $\log(\tau_{ij})$
Capital Controls - <i>i</i> (JW)	-0.386*** (0.108)		
Capital Controls - <i>j</i> (JW)	-1.528*** (0.147)		
Capital Controls - <i>i</i> (CI)		-0.070*** (0.018)	
Capital Controls - <i>j</i> (CI)		-0.737*** (0.027)	
Capital Controls - <i>i</i> (FKRSU)		-.437***	(0.108)
Capital Controls - <i>j</i> (FKRSU)			-0.549*** (0.154)
Corporate Tax - <i>i</i>	-1.671*** (0.418)	-1.578*** (0.280)	-1.170*** (0.409)
Investment Safety - <i>i</i>	0.156*** (0.022)	0.115*** (0.016)	0.142*** (0.019)
Observations	221,337	483,065	174,154
R-squared	0.056	0.116	0.021
Year FE	Y	Y	Y

Output Gains with Financial Globalization

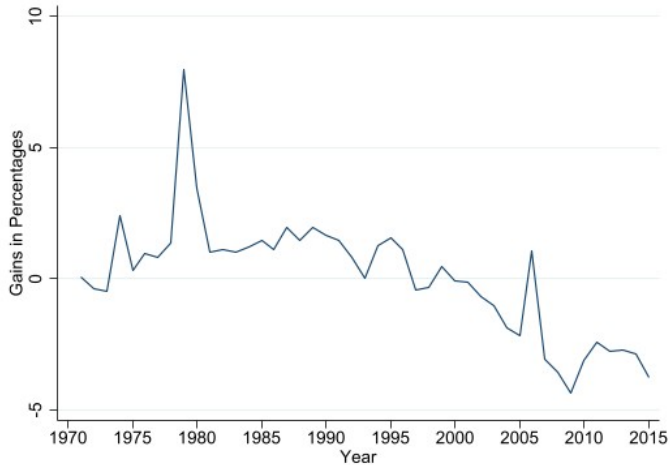


Figure: Output Gains due to Financial Globalization

Capital account liberalization

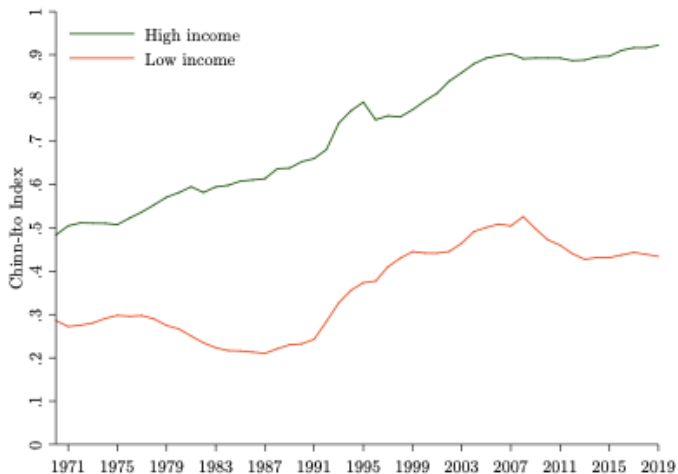
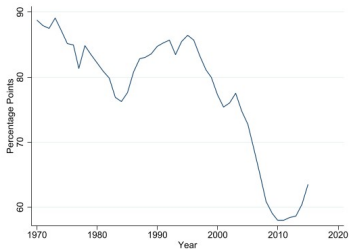


Figure: Chinn-Ito Index for High and Low-Income Countries

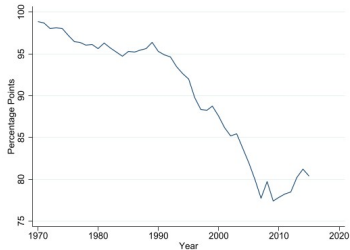
First, Second and Third Quartiles of Implicit Tax [Back](#)



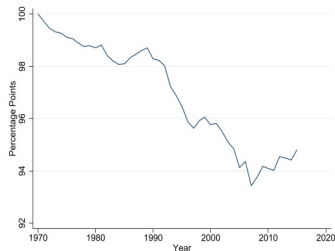
First quartile



Mean



Median



Third Quartile

Related literature

- **Open-Economy Macro-Finance**
Garleanu et al. (2019), Pellegrino et al. (2021)
- **Wedge accounting**
Chari, Kehoe, and McGrattan (2007), Restuccia and Rogerson (2017), Ohanian et al. (2018)
- **Drivers of financial globalization**
Alfaro et al. (2007), Lane and Milesi-Ferretti (2008)
- **Effects of financial globalization on output**
Henry (2007), Chari et al. (2012), Forbes(2007) and Alfaro et al. (2017)
- **Drivers of rising inequality within countries**
Autor et al. (2008), Goldberg and Pavcnik (2007), Caliendo et al. (2019), Piketty and Goldhammer (2014)

Output per capita

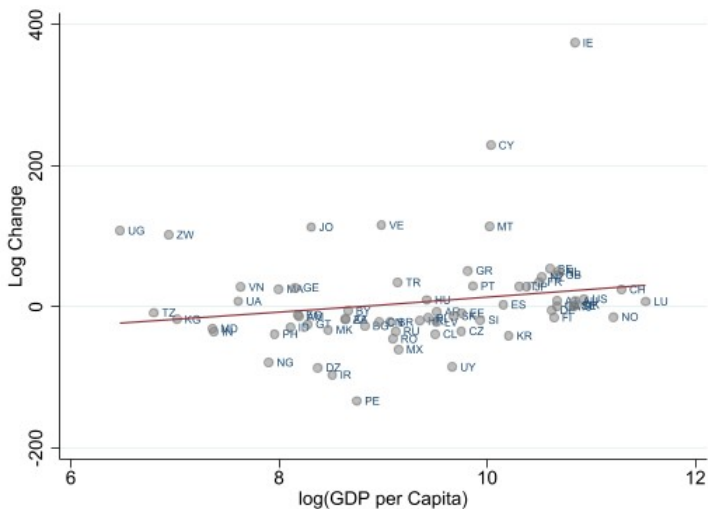


Figure: (Log) change in output per capita due to financial globalization

Wages

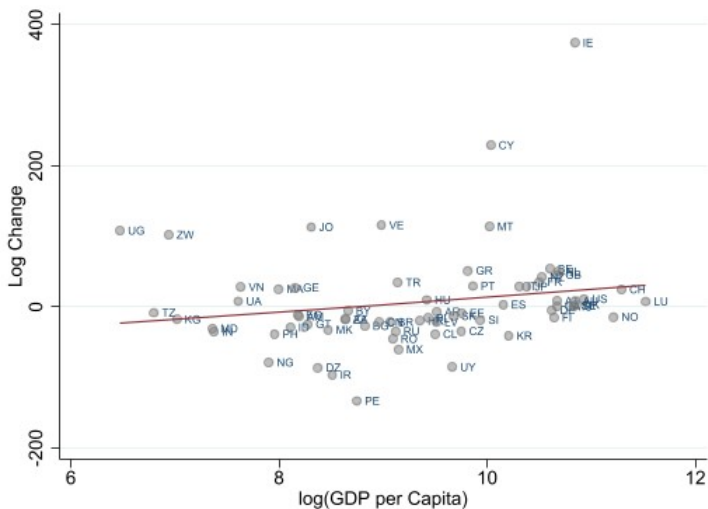


Figure: (Log) change in wages due to financial globalization

Returns to capital

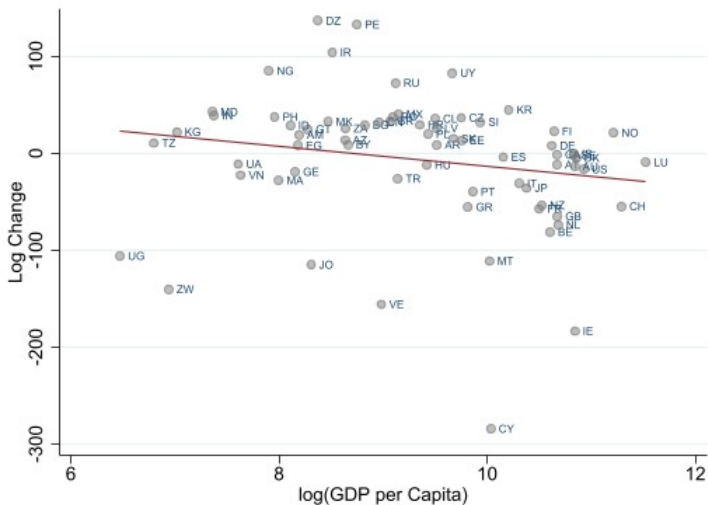


Figure: (Log) change in returns to capital due to financial globalization

Portfolios gross returns

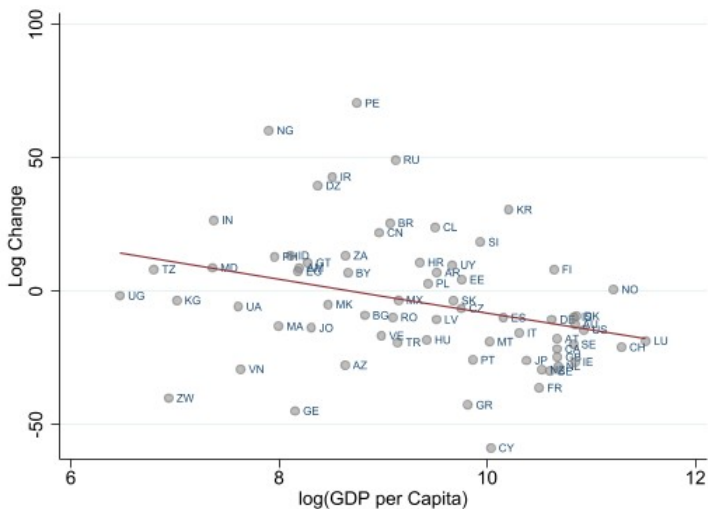


Figure: (Log) change in portfolio returns due to financial globalization