

**Emerging Trends in
Global Economic Governance:**
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Some emerging trends?

- Increasing dis-engagement in multi-lateral governance structure?
- Better self-governance in the shadow of increased globalization?

- **Trend #1?** Increasing dis-engagement with multilateral governance structure
 - Disenchantment with the IMF?
 - Build-up of FX reserve as a way to reduce reliance on a global financial architecture
 - Proliferation of regional initiatives
 - E.g., Changmai initiative, Chavez initiative
 - The “death” of the WTO Doha Round
 - E.g., “(Hilary) Clinton doubts benefits of Doha Round Revival” (FT December 3, 2007)

- **Trend # 1: Increasing dis-engagement with multilateral governance structure? Not so fast**
 - Disenchantment with the IMF?
 - No voice -> exit? Europe is the bottleneck?
 - India fares far better
 - Build-up of FX reserve
 - The special challenge of a large emerging market economy
 - Could the reserve dissipate as far as it has been built up?
 - Proliferation of regional initiatives
 - Has not been tested. Could be complements rather than substitutes
 - The “death” of Doha
 - Why about the eagerness for non-members to join the club?

- Trend #2? Better self-governance in the shadow of increased globalization
 - Firm level
 - Government level
 - Easy Money Effect vs Discipline effect

- Trend #2? Better self-governance in the shadow of increased globalization
 - Evidence supportive of the existence of this trend is stronger and more persuasive
 - Because some of the evidence comes from me 😊

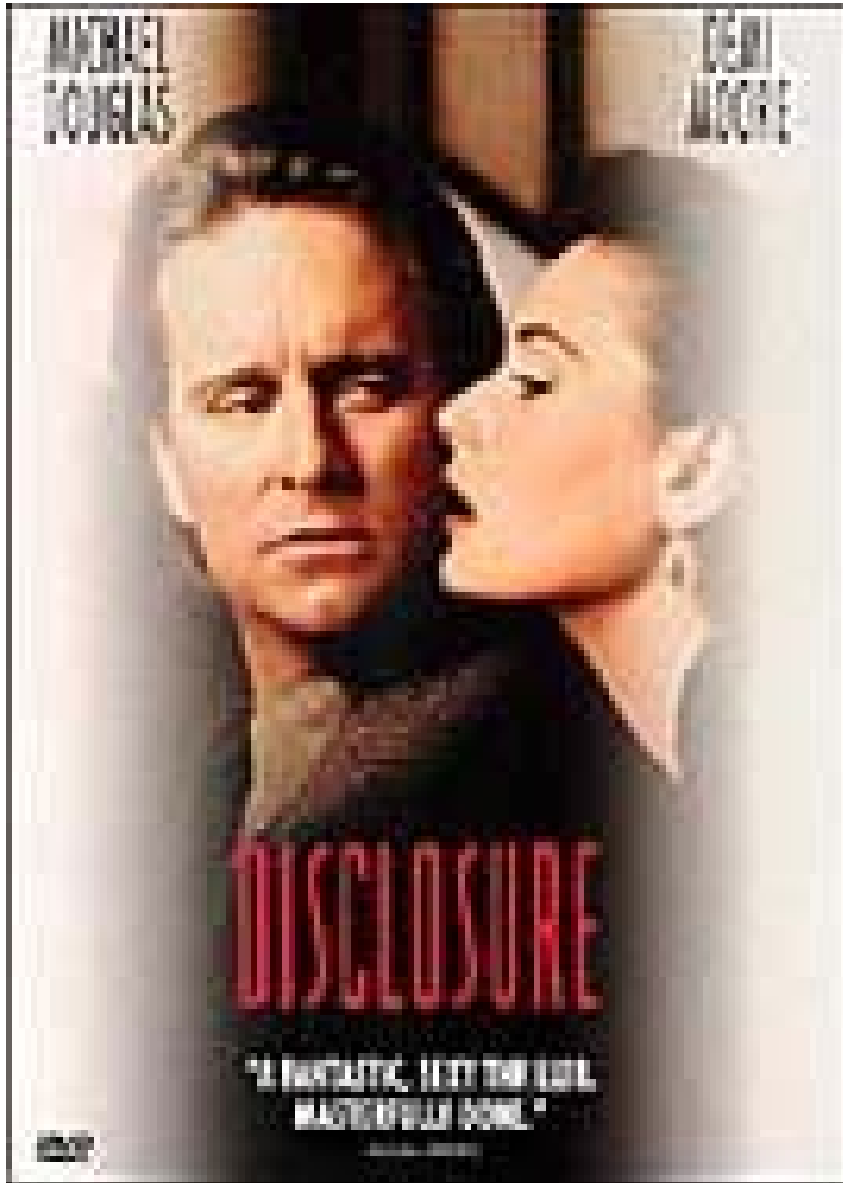
Example at Firm Level

- Does trade globalization induce better corporate governance voluntarily?

Mechanism

- Trade globalization (including foreign tariff reductions)
-> Firms' export opportunity improves -> they may wish to expand their production and may need more financing.
- To obtain more external financing, they may have to improve their corporate governance, including better financial disclosure, in order to make themselves more attractive to investors and creditors

- One can check
 - Whether foreign trade liberalization leads to voluntary improvement in corporate disclosure
 - Tong and Wei (2007)
 - 1200 listed firms in 50 countries during 1990-2004.
 - Useful features:
 - (a) The positive shock to firms' growth opportunity – foreign trade liberalization – is exogenous to the firms' corporate governance activities
 - (b) Tariff data are very detailed



How to measure disclosure?

Not the one on the left.

Quality of disclosure = forecasting accuracy of firm earnings by stock analysts,

Standard in the accounting literature

- Key Findings of Tong and Wei (2007):

1200 firms in 50 countries 1990-2004

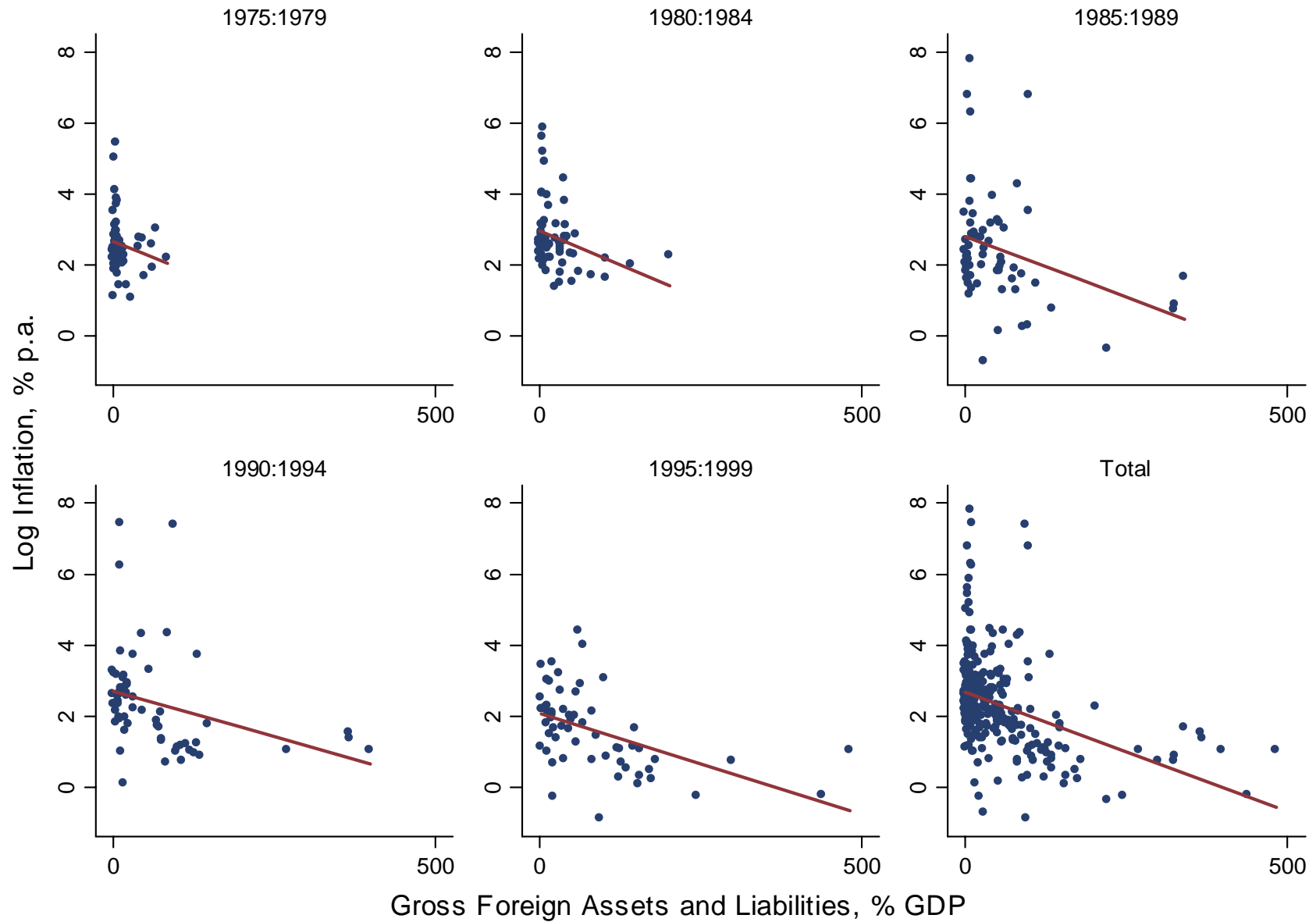
- Firms facing a greater increase in foreign trade opportunities show a greater improvement in their financial disclosure
 - 1 sd reduction in foreign tariffs -> 17% improvement in disclosure quality
- This effect is stronger for firms in sectors that have a higher intrinsic demand for external financing
- Financial globalization does not have the same effect

- **Trend #2?** Better self-governance in the shadow of increased globalization
- **Example 2: At the Government Level**
- Do governments pursue more responsible macroeconomic policies (e.g., lower inflation, and lower fiscal deficit) in response to increased cross-border capital flows?

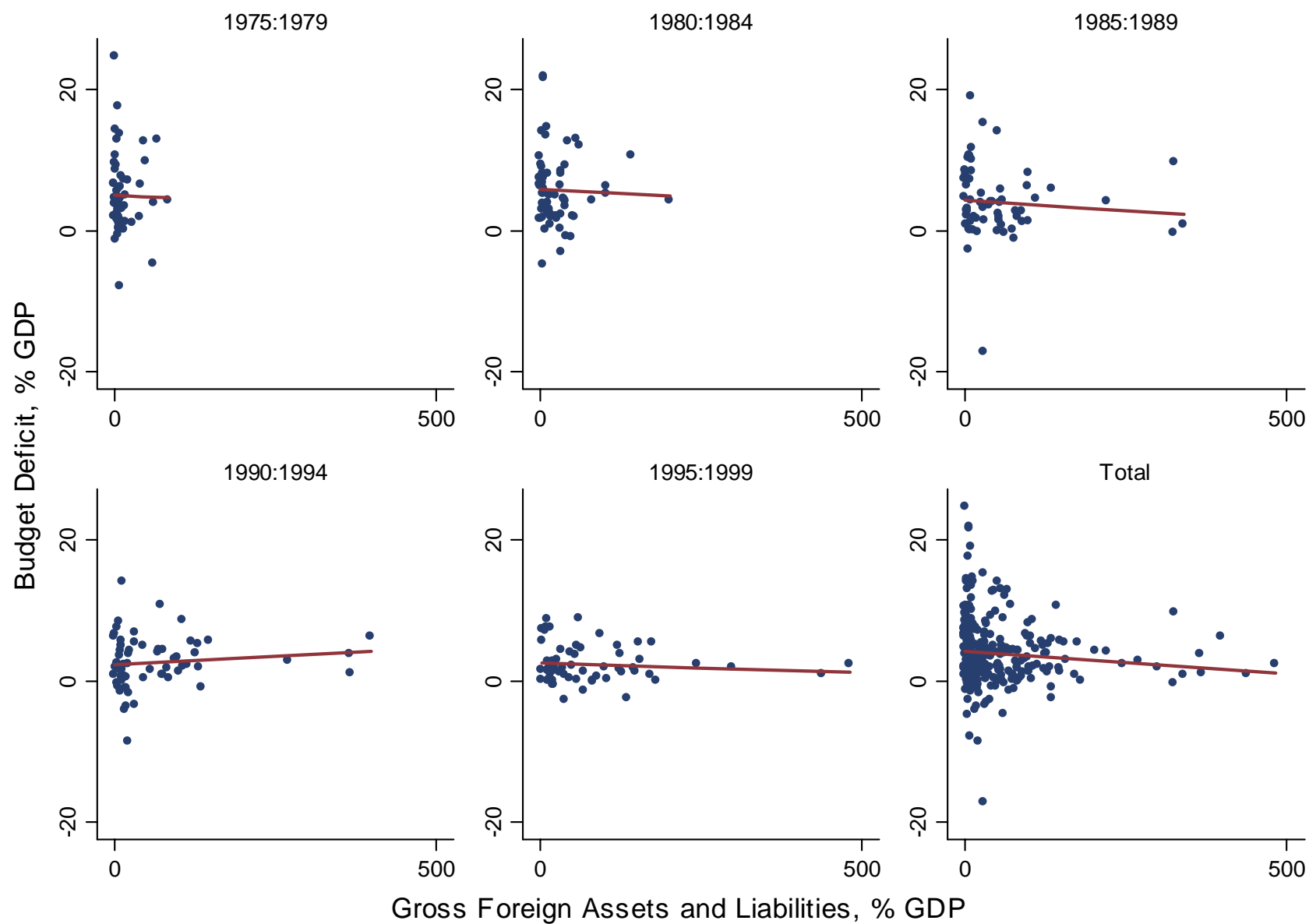
General trends

<i>Medians by period</i>	<i>1975:79</i>	<i>1980:84</i>	<i>1985:89</i>	<i>1990:94</i>	<i>1995:99</i>
	<i>Inflation (% p.a.)</i>				
Developing Countries	11.84	14.39	15.24	13.83	7.99
Industrial Countries	10.01	9.66	4.63	3.27	1.95
	<i>Budget deficit (% GDP)</i>				
Developing Countries	4.23	4.60	3.17	1.46	1.57
Industrial Countries	3.80	5.05	3.30	3.90	1.88
	<i>Exposure to Financial Globalization: Gross foreign assets and liabilities (% GDP)</i>				
Developing Countries	6.36	9.92	12.73	16.87	28.27
Industrial Countries	9.28	33.76	67.07	106.71	136.27

Log Inflation and Financial Globalization



Budget Deficit and Financial Globalization



- More systematic evidence?
- Tytell and Wei (2005): global capital flows and national macroeconomic policies

Method #1: Linear system of equations

$$\begin{aligned} \text{Log Inflation}_{it} = & \beta_i + \beta_t + \beta_1 \text{Budget Deficit}_{it} + \beta_2 \text{Financial Openness}_{it} \\ & + \\ & \beta_3 \text{Exchange Rate Flexibility}_{it} + \beta_4 \text{Central Bank Governors}_{it} + \\ & \beta_5 \text{Trade Openness}_{it} + \beta_6 \text{Industrial Countries}_i + u_{it} \end{aligned}$$

$$\begin{aligned} \text{Budget Deficit}_{it} = & \alpha_i + \alpha_t + \alpha_1 \text{Log Inflation}_{it} + \alpha_2 \text{Financial Openness}_{it} + \\ & \alpha_3 \text{Government Changes}_{it} + \alpha_4 \text{Government Coalitions}_{it} + \\ & \alpha_5 \text{Trade Openness}_{it} + \alpha_6 \text{Industrial Countries}_i + \varepsilon_{it} \end{aligned}$$

Instrument for Financial Openness: distance-weighted average across neighboring countries

Method # 2:

Transition matrix specification:

Markov chains with variable transition probabilities (as a function of a country's exposure to financial globalization)

- Key Findings of Tytell and Wei:
- Robust evidence that exposure to FG induces governments to pursue low-inflation monetary policies
 - Accounting for history, central bank independence, exchange rate regime, and trade openness
- No support for the notion that globalization has induced lower deficits

- Summary:

- Some robust evidence that globalization has induced improvement in economic government at both corporate and government levels
- Not a panacea (e.g., doesn't work for fiscal policies)
- Better to make friends with globalization than to stay away from it forever.



"Can Billy come out and compete in the global economy?"