Guide to exam Economic History of Globalization

Indicators. Simple indicators of the extent of globalization of capital markets are measures of the volume of gross and net flows and stocks of foreign capital. One commonly used flow is the (absolute) size of the current account (as a share of GDP).

More sophisticated measures relate to the efficiency of capital markets. Do they obey to the law of one price? If returns on equally risky assets converge across nations also controlling for exchange rate risks then globalization is increasing. More vaguely differences in returns should not diverge over time in a global capital market. A few words on equity markets are welcome and it is fine if the student is aware of home-bias in portfolio compositions.

Timeline. The rough outline suggests an increase in capital market globalization from the mid 19th century to the outbreak of WWI and then a sharp decline during the was, followed by a short revival of capital markets globalization in the 1920s. A sharpa decline in the 1930s continuing well into the 1970s, until the second globalization period starts and takes capital market globalization to levels similar or higher than just before 1914. It is important that the Bretton Woods period is characterized as a period of low levels of globalization.

Advantages and disadvantages of global capital markets.

The major advantage for investment and saving is that domestic investment is not constrained by domestic savings (which was important for Scandinavia in the second half of the 19th century) and the reverse that an excess of savings over investment can flow elsewhere. On the trade side the expansion of trade would not be thinkable if it was based on barter rather than international credit and convertible currencies.

On the negative side international capital markets constrain domestic policy markers and the extent of these constraints depends on exchange rate policy. In a fixed exchange rate system or a currency union with free capital markets national autonomy over domestic monetary policy has to be given up. It might be useful her if the students refers to the Obstfeld-Taylor trilemma in this discussion.

Referring to current affairs it is worthwhile dwelling on the link between international finance and banking crises. Historical evidence suggests that the extent of global capital markets are linked to the extent of domestic banking crises and sovereign defaults. In particular international finance seems to be involved in real estate and/or equity bubbles as suggested by the current crises and the Asian crises a decade earlier.