# GLOBALIZATION AND INTERNATIONAL FINANCIAL CENTERS ACTIVITY

**VALENTINA FETINIUC, IVAN LUCHIAN** *

**ABSTRACT:** *International financial centers are places of concentration banking and specialized financial institutions activities, engaged in international financial transactions. They have become elements of international market mechanisms that serve as controls global financial flows. The movement of the past carried out in the field of monetary and settlement services for the sale of goods and services, international investments, transactions with various financial instruments, foreign currency transactions. They have become points of support of financial globalization process, ensuring the normal circulation of international financial flows, and the link between local and international financial markets. This article examines the essence, the types and importance of specific territorial formations in the context of globalization.*

**KEY WORDS:** *financial globalization, international financial center, international financial centers rating, offshore financial centers, banking financial centers.*

**JEL CLASSIFICATIONS:** *F36, F65, G15.*

## 1. INTRODUCTION

Globalization - a process of increasing the impact of various factors of international importance (such as closer economic and political ties, cultural and information exchange) on the social reality in some countries. Globalization is an objective process, which determines the qualitative changes in the global space, increase interconnectivity and uniqueness of individuals or civilizations in general. The most powerful factor of globalization is economic one, manifested in the presence of multinational corporations operating in multiple countries and using new historical conditions to their advantage. (*Что такое, n.d.)*

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Globalization can be examined under multiple aspects: political, military, social, legal, informational, technological, cultural, ecological, economic and financial.

In terms of financial aspect, this is a consequence and an integral part of economic integration.

Further will be examined the process of financial globalization in the context of international financial centers activity.

## 2. FINANCIAL GLOBALIZATION OVERVIEW.

Financial globalization is a process which is an integral part of the overall process of globalization, aimed at creating a single financial market and flowing through increased international movement of financial capital. (Fetiniuc, Luchian, 2013)

Financial globalization means a reduction in formal barriers to trade in financial assets. (Stulz, 2005)

At the same time, it is a higher stage of the internationalization of financial markets in all its forms to ensure the needs of the development of monetary and financial relations. (*Финансовая*, n.d.)

In other words financial globalization is a process oriented to form a single financial market arising under increasing international movement of capital. (Nikolaev)

This process occurs by joining the financial markets into a single market and the creation of a global financial system. (*Финансовая*, n.d.)

The global financial market, in turn, increasingly emerges in two-tier architecture. The first is supranational or global, and the second is national. In terms of financial globalization boundaries between these levels gradually erases. (*Финансовая*, n.d.)

The evolution of financial globalization occurs in two ways (Fetiniuc, Luchian, 2013):

- Qualitative;
- Extensive

The qualitative (internal) way is expressed by important institutional changes, which are, on the one hand, withdrawing the various barriers to the cross-border movement of capital, and, on the other hand, in establishing cooperation between the financial institutions of different countries, up to complete their merger. As a result, national financial (stock) markets are interrelated parts, in fact, a single, integrated world market.

On the other hand, should take into account the fact that financial globalization proceeds in terms of creating a new global financial system

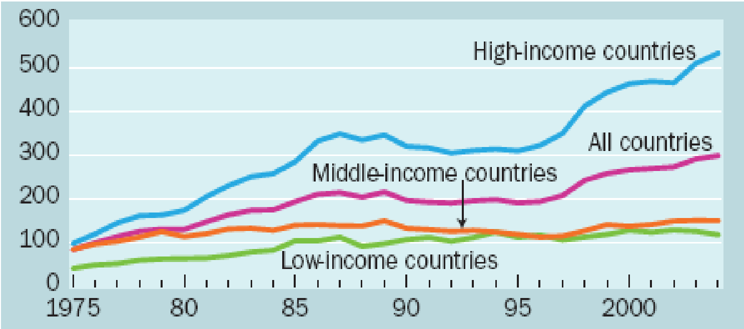
The extensive way is spread in breadth, which finds expression in the rapid growth of quantitative parameters characterizing the momentum of world trade, foreign direct investment and international financial borrowings.

Development of financial globalization occurs in the following forms (Fetiniuc, Luchian, 2013):

- The substantial increase in the average volume of transactions in the international market;

- Transformations of global foreign direct investment (FDI);
- Expanding global capital market;
- Increasing global derivatives market;
- Develop international banking system;
- The emergence and development of international financial centers;
- Development of international financial institutions.

Paolo Mauro and Jonathan D. Ostry consider that financial globalization is promoted mainly by high-income countries, which is represented graphically in Figure 1.




*Source: Mauro, Ostry, 2007*

**Figure 1. The dynamics of gross external assets and liabilities (percent of GDP)**

They wrote: “High-income countries account for most of the increase. In low- and middle-income countries, average increases have been more moderate. Within this group, however, there is also substantial variation. Countries in East Asia have, on average, experienced a six fold increase. Central and Eastern Europe has experienced a threefold increase. This compares with a more modest twofold increase for low- and middle-income countries as a whole.”

In the opinion of these authors the exposure of financial globalization process status can be determined in the following ways (Mauro, Ostry, 2007):

• *Stock measurements.* The size of gross stocks of external assets and liabilities is by now the most widely used measure of international financial integration. It is calculated as the sum of gross external assets and liabilities relative to a country's GDP.

• *Flow measurements.* In a completely closed economy, savings must equal investment. Therefore, one way to calculate financial openness is to calculate the difference between savings and investment flows. In practice, however, this measure has not proved very useful because savings and investment are highly correlated even in countries that seem fully open to capital flows from abroad.

• *Price-based measurements.* If a country is fully integrated with the world economy, there should be no possibilities for investors and traders to exploit price differences for goods and services. Following this logic, financial openness can also be measured by comparing interest rates, or prospective returns on financial instruments, in different countries.

Financial globalization mostly occurs through the activity of international financial centers.

Globalization has connected New York, London, Tokyo and Zurich centers specializing in special functions: Frankfurt, Luxembourg, Vienna, Amsterdam, Paris, of Hong Kong, the Bahamas and the Cayman Islands. Strengthening the links between these centers has led to the spread of the international financial institutions, international financial integration and the rapid development of financial innovation, which, in fact, is the content of financial globalization (Klimachev, 2010).

## 3. THE ESSENCE OF INTERNATIONAL FINANCIAL CENTERS

Saskia Sassen wrote: "The transformation of global capital markets into a new supranational order is continuing apace despite the current market crisis. Nationally based financial operations are shrinking and internationally oriented operations are taking their place. Globalization usually implies decentralization. But while the international network of financial centers is indeed expanding, a leaner system dominated by a handful of strategic cities is evolving. As financial operations disperse around the world, only a few cities will have the resources to be dominant" (Sassen, 1999).

The financial centre is a city with a large number of banks, stock exchanges and business with an international significance (*Financial*, n.d.).

From another point of view "an international financial centre is a hub where cross-border financial business with counterparties around the world can be conducted easily and efficiently. Among international financial centers, a small number stand out as truly global financial centers. Their global reach derives from high levels of expertise in a range of financial products and services; from business networks which span the world; from collective liquidity which allows them to handle the largest transactions; and from their reputation for efficient markets and fair legal systems." (*From*, n.d.)

Researcher Michael Mainelli states that successful financial centers can be examined from the standpoint of their role in the international financial system (Mainelli, 2009):

- *Global* - meet financial centers that are really financial foci such as London, New York, Hong Kong and Singapore;
- *International* - it is about financial centers in carrying a significant amount of cross-border dealings (e.g. Seoul, Shanghai, Frankfurt am Main);
- *Niche* - financial centers as global leaders in one sector (such as Hamilton or Zurich and Edinburgh reinsurance fund management).

An international financial centre usually has the following basic aspects (*International*, n.d.):

1. Has a high concentration of financial institutions;
2. Provide a commercial infrastructure and highly developed communication;
3. Place, which carries a large number of domestic and international commercial transactions.

International financial centers form an international market mechanism that serves as a means of international cash management.

International financial flows, in turn, are focused on the following basic channels (Luchian, 2014):

1. Currency and credit servicing and settlement on the purchase-sale of goods and services;
2. International investments;
3. Transactions with securities and other financial instruments;
4. Currency operations;
5. Financial assistance provision by some countries other countries;
6. Participation of states in financial institutions financing;
7. Other destinations.

## 4. INTERNATIONAL FINANCIAL CENTERS RATING

At present the world there are 83 international financial centers, which are grouped in a top perfected under Global Financial Centres Index. (*Global*, n.d.) The same purpose is applied International Financial Centers Development Index (*Financial*, n.d.).

Table 1 presents the top 10 of the most important international financial centers for 2015 according to both systems estimation.

**Table 1. International financial centers Top for the 2015**

| **Global Financial Centers Index** | | |
|---|---|---|
| **Rank** | **Center** | **Rating** |
| 1 | London | 796 |
| 2 | New York City | 788 |
| 3 | Hong Kong | 755 |
| 4 | Singapore | 750 |
| 5 | Tokyo | 725 |
| 6 | Seoul | 724 |
| 7 | Zurich | 715 |
| 8 | Toronto | 714 |
| 9 | San Francisco | 712 |
| 10 | Washington, D.C. | 711 |

*Source: London, n.d.*

During the period of 2007-2013 London stably keeps the first place in the international financial centers ranking, and New York, the first in 2006, was ranked second. And in 2014 New York ranked London among the largest financial centres of the world. This took place after the scandals in The City of London and and the status of Great Britain as part of the European Union has been in doubt. (*New*, n.d.) But in 2015 London regained leadership.

London is the world's largest derivatives market: their annual turnover is 1.4 trillion USD which is 46% of the total turnover in the world. London is the world's largest currency exchange market (40% of the world volume). In The City, which is more than in other financial centers around the world, operates 251 foreign banks.

Through the UK capital is held 18% of cross-border transactions on bank lending, which is also the highest world average. Companies located in London have access to capital around the world. In fact, London is a vast financial web which attracts cash flows with almost all offshore centers in the world (Popkova, 2012).

New York concedes leadership to London, however, is the city with the greatest liquid stock market of the world. The significant impact on the positions of New York as a global financial center had terrorist attacks September 11, 2001. Increased security measures led to a reduction of foreign business trips to the United States and decrease in the number of transactions, transfer of accounts from US bank (Popkova, 2012).

To reduce the dominance of New York as an international financial center has contributed the adoption of the 2002 Sarbanes-Oxley Act, aimed to financial reporting requirements tightening and the process for its preparation. The adoption of this Act was preceded by a series of numerous corporate scandals involving the falsification of statements by managers of large corporations. This resulted in higher costs and risks for foreign companies to withdraw their securities from the New York Stock Exchange, which led to the partial reorientation of foreign issuers in the European exchanges. However, despite the tightening of rules on control and regulation, New York remains one of the world's leading financial centers of the world. This contributes to the high investor confidence, resulting in large amounts of foreign direct investment (Popkova, 2012).

In recent years, increased competition between the world's financial centers, which is caused by a number of factors (Popkova, 2012):

- Active economic growth in developing countries has caused the need for redistribution of financial flows, creation on the territory of these states of their own financial centers;
- The formation of regional monetary unions helped to strengthen the role of regional international financial centers;
- High cross-border migration of financial flows in the global capital market determines a great opportunity for investors when choosing jurisdictions to place their capital. This situation resulted in a number of countries with small national economies to specialize in financial services. Favorable conditions for financial market participants have allowed them to form on its territory and to redirect the financial centers of the capital flows from traditional financial markets;
- Traditional international financial centers have realized the potential loss of leadership positions, and have developed their own strategy for the 2015-2020. In 2007, the strategy was presented to development of New York as a global financial center, aimed at the conquest of leadership in the ranking of the international

financial centers. The aim of the development strategy is the transformation of Zurich in Switzerland with some tools of competitiveness improvement.

Tools to improve the competitiveness of international financial centers are (Popkova, 2012):

- Advanced tools and financial markets infrastructure development;
- Development of new approaches to financial sector regulation;
- Tax systems improvement;
- Training system improvement;
- Cash management technological systems modernization.

As an effective strategy to strengthen the competitiveness on the financial market states use consolidation of exchanges on the territory of one state and within different countries.

An obvious example is exchange groups creation: NASDAQ OMX stock, NYSE Euronext, CEE Stock Exchange Group and London Stock Exchange Group.

The most remarkable is NASDAQ OMX Group, Inc., which is actually the largest stock exchange in the world with over 3300 employees. NASDAQ OMX's technology solutions are applied to over 70 stock exchanges, clearing organizations and central depository of securities in more than 50 countries. NASDAQ OMX is listed in the 3500 companies with a market value of 9.1 trillion USD and serviced over 10000 corporate clients (*NASDAQ*, n.d.).

NYSE Euronext is a Euro-American multinational corporation and international financial services provider, which manages several stock exchanges, including the New York Stock Exchange, Euronext and NYSE Arca. NYSE Euronext is an exchange operator with a total of 3,000 employees and a market capitalization of listed companies equivalent to 15 trillion USD (*NYSE*, n.d.).

## 5. OFFSHORE FINANCIAL CENTERS

Offshore financial centers are typically small jurisdictions easy tax regime, specializing in corporate and commercial services provision to non-residents in the form of companies and investment funds related to their management and registration (Harari, Meinzer, et al., 2012).

In other words, an offshore financial center can be defined as a system that provides development, legislative, financial and business infrastructure, which is more flexible than orthodox infrastructure and tends to satisfy the needs of non-resident investors (*Offshore*, n.d.) (Antoine, 2013).

Usually offshore centers have the following items (*Centre*, n.d.):

- Permissive legislative framework, especially as regards the transfer of money, the accounting system, shareholders;
- Transactions are carried out between nonresidents and their volume often exceed the volume of business conducted by residents;
- The minimum amount for a deposit is relatively high and most of the operations is from wholesale;
- Privacy policy of operations and bank secrecy;
- Mostly tax and legislation incentives are related to international business;

- Banks usually are exempt from local taxes or symbolic rates charged;
- Are often used to obtain loans in Eurocurrencies at relatively low interest rates.

At present in 13 global offshore centers are concentrated over 1,000 transnational bank branches (Nikolaev). As an example can serve Cayman Islands and in Europe are popular in Manche Strait Islands and Isle of Man.

Offshore centers are main "nodes", the through which financial and investment flows of the global economy. The annual export of capital from the Netherlands, Luxembourg and Ireland is 10-12 trillion USD, which is higher than the export of capital from the United States. Portfolio investments from islands of the Caribbean and Normandy are equal to 1/5 of portfolio investment from the United States. It should be noted that offshore are not only points of powerful financial flows. They are still management centers of companies in many countries (*Офшоры*, n.d.).

Often offshore centers are called "black holes" of the world economy, because in offshore centers funneling huge financial resources needed for social and economic development of nations and because they are totally opaque, no information about the operations and financial and property status of offshore companies and their beneficiaries (*Офшоры*, n.d.).

According to the report of the international research organization Tax Justice Network, engaged in independent investigation in the field of tax evasion, in bank accounts of offshore jurisdictions in 2011 were from 21 to 32 trillion USD, without taking into account non-financial assets as numerous luxury items and works of art. These amounts correspond to at least a tenth of the total volume of the world's wealth, estimated by the Swiss bank Credit Suisse 231 trillion dollars (*Офшоры*, n.d.).

## 6. BANKING FINANCIAL CENTERS

In some bibliographic sources experts in the field prefer to use the concept of financial banking centers on three models indicate such territorial formations (*Оффшорные*, n.d.), (Luchian, 2014):

- ***New-York model*** – provides formally through special arrangements with renowned financial centers such as New York, Tokyo, Singapore. On these markets, are open special accounts separate from domestic and these accounts are free of restrictions that apply to domestic financial markets (such as the obligation reservation required). There exists taxation of profits, local tax (the Tokyo market) may be admitted (Singapore) and may be exempt from taxation of corporate securities (market of New York and Tokyo).
- ***London model***. In London and Hong Kong financial agreements are free from restrictions, whether residents or non-residents are market participants. In these cities offshore market consists of agreements between non-residents and combined internal and external agreements. Offshore markets and profit taxation model admits tax on corporate securities.
- ***Tax shelter model.*** To such offshore markets concerns Bahamas and Cayman Islands markets. In these markets agreements between non-residents are not subject to duties, missing income tax and the taxation of securities transactions, but there are registration fees and license fees.

## 7. CONCLUSIONS

Financial globalization is a derivative form of progress of economic globalization expressed by deepening interdependence of countries worldwide through increased cross-border transactions, financial services and capital flows, wide dissemination of financial technologies. It appears by free movement of capital between countries and regions of the world. International financial centers have become inseparable components of financial globalization. They manifest in different forms, but as a whole provides the connection between local financial markets and international financial market, forming a harmonious complex designed to ensure free movement of capital both within related countries and globally.

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