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The Globalization of Capital Markets
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INTRODUCTION

1. Capital markets are in the process of rapid evolution. Capital flows — which were formerly directed towards banks and controlled by Governments — are now held by individuals, institutions or private mutual funds and can circulate freely and instantaneously to projects which will yield the maximum profit. Electronic computerized data transmission now gives them an unprecedented mobility on all the financial markets on the planet. Moreover, the volume of such flows has grown — tripling or increasing tenfold in the past few years — mainly as a result of the success of mutual funds, whose assets often exceed those of many Governments.

2. We will examine, in turn, the current evolution of capital markets and the attempts made by Governments and international organizations to regulate them, as well as the political and economic consequences of the globalization of capital movements. Lastly, we will consider the future prospects in an attempt to find an answer to the fundamental question: Will the sole purpose of the globalization of capital markets be speculation, or can this globalization be mobilized to promote economic growth, social progress and development?

I. CURRENT EVOLUTION OF CAPITAL MARKETS

A. Previous situation

3. In the past, rivalries between nations were resolved by means of armed conflicts in which empires or ideologies clashed. Today, the wars being waged seem increasingly to be removed from the principal events taking place on the economic and financial front.

4. During the Cold War, the super-powers provided assistance in the form of official financial flows or subsidies to centralized economic systems and developing countries whose survival they ensured. Today, these flows and subsidies have been considerably reduced or have even, in some cases, disappeared, giving way to the laws of the market place which govern growth, development, employment or decline.

B. Current situation

5. Today, the main problem facing Governments is how to attract new investment with a view to creating jobs and promoting sustained economic growth. Governments compete for capital. To this end, nations vie with each other through variations in their interest rates or their rates of exchange, and through the competitiveness of their markets. The world has become capitalist and the ever-increasing financial movements can reward savings and productivity and thus strengthen a country’s economy. Conversely, foreign capital can also abandon an economy or withdraw abruptly if an unfavorable fiscal policy drives it away. Speculators may attack a weak currency to weaken it still further. Capital movements may penalize unproductive expenditure and thus help to destroy a country's economy. Governments and heads of enterprises therefore
strive to attract this capital by offering it favorable conditions and to utilize it more productively than their rivals.

6. With the end of the Cold War, official subsidies and other financial flows dried up in countries such as the Democratic People’s Republic of Korea, Myanmar and Cuba, while investors preferred to steer their capital to countries where the climate was more favorable to them, such as the Republic of Korea, the Taiwan province of China and other emerging countries. Capital has thus become more mobile and more difficult to stabilize and control.

C. Demand for capital

7. During the 1990s, over 50 developing countries have created capital markets. During this period, 3 billion people have freed themselves from Marxist or government-controlled economies. These countries need capital to get their new market economies to take off. In Asia and Latin America, economies are in a state of full expansion; they must establish infrastructures and find capital to sustain their economic growth. After a period of recession, the United States of America, Europe and Japan also need capital to finance their expansion, create jobs, make good their budget deficits and privatize their State enterprises.

8. In the face of this increased demand for capital, the competition has become increasingly fierce. In order to attract these financial flows and pay a return on them without over-burdening the costs of production, some countries have had to resort to lowering wages or extending the working hours. Moreover, the increasing budget deficits of the United States, Europe and Japan have triggered an additional demand for capital. The financing of these deficits has reduced the amount available to sustain the economy at the very time when it is emerging from the recession of the late 1980s. The indices already show the importance of these demands for capital: interest rates in Europe are rising while inflation is declining. Loans are becoming increasingly expensive, and risk breaking the recent cycle of recovery.

9. The countries with economies in transition are also seeking capital. The dearth of capital had already led to the fall of the Soviet empire, which had been unable either to create sufficient capital or to utilize it effectively. China and India have appealed to the capital markets in order to avoid a recession.

10. In South Africa, reforms became essential when the international embargo, including the embargo on capital, led to the country’s paralysis. Lastly, Argentina, abandoning its government-controlled policy, has now opened its frontiers to capital imports and has privatized its national companies (railways, highways, ports, and so on), thus bringing about the economic expansion of the country following the investment of $10 billion raised on the international capital market.

11. All these countries are feverishly engaged in establishing a complete capital market infrastructure. The first countries to achieve this will have the benefit of direct and preferential
access to international investors. In this context, many countries are planning to establish derivative markets, including futures markets and options, which will allow improved coverage of risks related to stocks and shares, bonds and exchange rates. Thailand, for example, will shortly establish a currency and interest-rate futures market.

D. Supply of capital

12. Private capital is offered on the world investment market for the purchase of bonds and shares in companies and is outside government control. Where does this capital come from? Who owns or manages it? The capital comes mainly from mutual funds, pension funds or insurance funds and, thanks to a worldwide network of computerized communications, it circulates freely in search of the maximum profit. In some cases, the managers come from Wall Street and have become international celebrities. In others, they are obscure managers of institutions such as the New York State Teachers’ Pension Fund or the Robeco group in the Netherlands. More often, they are the managers of investment funds such as the Pacific Investment Management Company in California, which controls assets amounting to over $55 billion.

13. The assets of institutional investors amount to approximately $8,000 billion in the United States and $6,000 billion in Europe. At present, these funds have invested less than 1 per cent in the emerging markets. All projections indicate that investment in these markets will increase to 5 to 10 per cent of the total assets in the next 10 years. These investors are now convinced that the emerging markets offer higher returns than those of the industrialized countries and that the risk can be controlled by a policy of diversification. There is therefore a unique opportunity during which countries seeking capital will have access to the resources of the industrialized countries.

14. On the other hand, it will be noted that some traditional capital-exporting countries have become debtors. For instance, Saudi Arabia’s petrodollars have dried up. The Federal Republic of Germany, which in 1989 exported capital amounting to $80 billion, has been importing it in the amount of $20 billion a year since its reunification with the German Democratic Republic.

E. Volume of capital movements

15. According to estimates, the volume of mobile international capital now amounts to $3,000 billion. This volume has tripled in three years. It currently represents three quarters of the total of the national budgets of the seven major industrial countries in the world (G-7). Moreover, capital flows to the emerging countries exceeded $200 billion in 1994, whereas they amounted to only $80 billion in 1989. Private capital accounts for the whole of this increase.

16. While bank loans are regulated and require guarantees from Governments, the International Monetary Fund or the World Bank, private capital circulates and can be invested almost freely.

17. The composition of capital has also evolved in recent years. Capital is composed of direct
investments, in which the purchaser retains control of the investment, loans — either bank loans or secured loans — and stocks and shares. Capital movements on the stock market have increased very rapidly and now amount to approximately $50 billion a year.

II. ATTEMPTS AT REGULATION

18. The free circulation of capital outside government control has led to the transfer of the concept of power, traditionally invested in Governments, to private holders of capital. This development explains the inability of central banks to curb the speculations which have recently attacked the value of the yen, the dollar and the European currencies. Governments have thus seen their ability to control their budgets and their capital reduced. Their fiscal resources appear to be reduced in relation to private capital and no longer allow them to make the necessary investments. The same applies to the international financial institutions, the World Bank and the International Monetary Fund, which are financed by Governments.

19. In contrast, multinational financiers, managers of private funds and directors of companies or banks tend to become increasingly powerful. Governments urge them to steer their clients’ investments towards their countries: the emergence of private capital as a leading actor on the international scene marks a great turning-point in the evolution of world financial management. After the Second World War, it was generally believed that Governments were responsible for the allocation of resources. Today, it is the markets which have taken over this role, thus confirming the decline in State-control or New-Deal trends.

20. Moreover, until the early 1980s, Governments endeavored to regulate the international monetary system and capital movements for fear of losing their natural capital and control over domestic economic policy.

21. Attempts at authoritarian regulation have, however, failed, as is evidenced by the collapse of the economies of totalitarian regimes and the difficulties encountered by welfare states since the late 1980s. In different ways, they are the root cause of the disasters experienced by the Soviet Union and the budgetary collapse of the West.

22. Those countries which have attempted to impose severe restrictions on capital movements have generally had to recognize the fluidity of the financial markets, which have moved towards more welcoming political centres, thus creating an offshore industry which still exists. Governments have been compelled to reduce the barriers to capital movements and, in particular, to reduce the amount of tax deducted at source on foreign investments.

23. The liberalization of trade has been accompanied by a liberalization of capital exchanges. According to some financial circles, it would seem that the world capital markets have become “the International Monetary Fund of the 1990s.”

24. From the standpoint of Governments responsible for controlling emerging markets,
the question of the taxation of capital flows is extremely important. Such taxes can be useful if they are used to build a market infrastructure. Too high a rate of taxation, however, would drive investors away. The key is to find a proper balance which takes account of the experience of other countries. Brazil, for example, has just imposed a tax of 1 per cent on foreign investments and this has apparently not reduced the flow of capital.

III. CONSEQUENCES OF THE GLOBALIZATION OF CAPITAL MARKETS

A. Beneficial economic consequences

25. The globalization of capital has beneficial characteristics in many respects. In order to attract the capital necessary for their development, national economies must become, or remain, open to foreign investment and must adopt responsible fiscal and monetary policies.

26. A fully developed financial market also makes it possible to steer investments towards the most useful projects, and thus to acquire the indicators essential to a market economy. This development will be achieved more rapidly if foreign investors have access to the domestic market. Since Brazil opened the BOVESPA stock exchange to foreign investors, the volume of transactions has increased tenfold. Besides contributing capital, world capital also permits the transfer of essential technology which makes it possible to develop a financial market architecture.

27. The majority of Governments have made economic stability one of their highest priorities. Thus, the lowering of customs barriers has introduced competition into previously protected markets. If Governments impose excessive regulations or too high a rate of taxation, if public expenditure is too high in relation to revenue, and if the central banks destroy too many liquid assets, foreign capital will not be attracted or it will be withdrawn if it is already there. International mutual funds have become a strategic weapon in the arsenal of democracies.

B. Adverse consequences

28. The play of market forces may, however, also have adverse consequences. The decision-makers and controllers of capital, indeed, turn away from States which are experiencing serious budget deficits or whose budgets are burdened by considerable social expenditure. Deficits and the absence of economic and financial reforms may dissuade capital from investing in the countries in question. The gap between rich and poor may therefore widen in the face of the exigencies of this Social Darwinism and the rigid rules of capitalist disciplines.

29. The threats confronting the welfare States do not, however, come only from abroad. Sweden, for example, owing to its generous social expenditure, currently has such a large deficit that some of its major industrial enterprises are considering moving their businesses abroad; the same applies to the United States, where the return to economic growth has given rise to fears of
too rapid expansion and renewed inflation. The bond market has reacted, interest rates have risen and the currency has depreciated. In Mexico, following the assassination of the presidential candidate, capital has fled for fear of an unfavorable political climate. In China and Viet Nam, on the other hand, capital has flooded in too rapidly, bringing in its train a rise in inflation and the overvaluation of the currency.

30. Lastly, it is believed that, if Governments reduce taxes on capital movements, create offshore markets and establish a stable and convertible currency, private capital will flow in.

C. Domestic savings

31. Domestic savings are clearly the alternative solution to the call for foreign capital. Savings have, however, decreased in recent years, since prosperity has placed more consumer goods on the market. Traditionally, it was national savings that supplied the economy with investments which ensured growth and employment.

32. Today, however, Governments have difficulty in keeping these reduced savings within the country. For example, the United States is the largest exporter of capital in the world, despite a considerable budget deficit which the use of domestic savings would help to clear or to reduce; the United States deficit, however, is financed mainly by foreign capital. In Chile, Australia and Mexico, Governments have established mandatory savings plans. Since the restructuring of the pension system, the State has encouraged the development of private pensions, which have increased the rate of savings and are invested mainly in the stock market.

IV. CONCLUSIONS

33. The globalization of capital markets and the growth of trade will help to create new surpluses which could meet the world demand for capital. However, these financial resources, in search of an attractive rate of remuneration, will be invested in countries which achieve a fundamental balance in their public finances and introduce economic and financial measures aimed at reducing budget deficits and current payments, the rationalization and privatization of public enterprises, the development of private savings and of the capital market, and the liberalization of trade.

34. During the past decade, a growing number of developing countries, emerging countries and economies in transition have introduced the reforms necessary for the restoration of financial equilibrium. However, the need to attract external financial flows which could contribute to the creation of jobs and the growth of their economy required, in particular, in the context of the globalization of capital markets, a greater effort in favor of national capital markets. The development of such markets, combined with national capacity building and the establishment of institutions connected to the international financial centres, would help to enhance the effectiveness of financial mediation in the allocation of resources, to channel external flows, and
to increase and diversify the volume of medium and long term financial resources necessary for the economic development of these countries. Lastly, these flows, both internal and external, cannot fail to constitute a source for the mobilization of additional resources through appropriate taxation.