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Competition between Economic Systems and Economic Policies in the Era of Globalization

Factors supporting global integration of financial markets:

- Liberalization of international trade
- Liberalization of capital accounts
- Liberalization of banking sector and other segments of financial market
- Trans-national expansion of great non-financial corporations and banks
- Privatization of banks and other financial institutions in developing and transition countries
- Technical progress in transport, telecommunication and information technologies
- Increasing level of education

Technical progress (the key factor)

$\Downarrow$

Lower transaction costs

$\Downarrow$

Higher capital mobility (and personal mobility)

Consequence of globalization:

Possibility to choose location of business activity, place of residence, and move capital between countries

Examples of systemic competitions:

- Tax systems (particularly direct taxes)
- Social-related costs
- Registration and licensing regime
- Labor market elasticity
- Property rights protection and quality of justice administration
- Quality of state institutions (including level of corruption)
- Quality and stability of financial sector
- Development of technical infrastructure
- Competition between currencies (currency substitution)
- Political stability and predictability of economic policy

Competition between currencies

$\Downarrow$

Also inside a country (currency substitution)

Currency substitution

- Undermining national monopoly of money emission and collecting seigniorage
- Analogies with „free banking"
- Limited room for monetary policy activism (e.g. anti-cyclical „fine tuning", stimulating growth, fighting unemployment, export promotion, curing instability of a banking sector)

How sustain a systemic competition?

- Domestic institutional reforms
- Importing institutions from countries representing high institutional standards

Examples of institutional outsourcing:

- Adopting EU *acquis communautaire*
- Membership in international organizations (IMF, WTO)
- Importing legal regulations
- Resorting to foreign arbitrage
- Listing on foreign stock exchanges
- Currency board/ unilateral dollarization/ euroization/ monetary union
- Technical assistance
- Openness to foreign investment in financial sector and infrastructure

Positive effects of systemic competition:

Limiting room for bad economic policies

"*the capital market fulfills an important supervisory functions over economic policy*"

Dornbusch (1998): *Capital Controls: An Idea Whose Time is Past?*, Essays in International Finance, No. 207, Princeton University.

Negative effects of systemic competition: incentives to escape regulatory standards (e.g., some ship registers, off-shore zones, tax havens, tolerance of money laundering)

European Union and systemic competition:

- Higher internal competition as result of free movement of capital and people
- Lower internal competition as result of legal, regulatory and tax harmonization, and introduction of common currency
- External competitiveness of EU comparing to US, Asia and other regions