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How Does Financial Globalization Affect Government Size?

What is this research about?

The volatility of international capital flows to emerging markets has been well documented. Financial globalization may not in general fulfill its theoretical role as a risk sharing mechanism in financially underdeveloped economies, and hence may provide an impetus for compensating government spending. The research examines if there is an empirical relationship between government size and financial openness.

What did the researcher do?

The researcher looked at a large sample of developed and developing countries during the rapid expansion of private international capital flows in the 1980s and 1990s. The researcher examined the relationship between government size and financial openness for 87 developed and developing countries.

What you need to know:

More open economies have larger governments because the public sector functions as a compensatory mechanism against risks associated with trade and financial globalization

What did the researcher find?

The researcher found that economies with greater exposure to cross-border capital flows tend to have larger government size. However, the researcher also found that richer countries with open economies tend to have relatively smaller governments as a percentage of GDP compared to poorer developing ones. These findings confirm the hypothesis that the benefits of risk sharing as a result of financial integration only happen after a country reaches a certain level of financial development.

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How can you use this research?

Policymakers and community groups can use this research to highlight the potential compensatory role that the public sector plays in limiting the risks associated with globalization, particularly in countries with less developed financial markets.

About the Researcher

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Trade openness, Risk sharing, Financial globalization, Government size, Developing countries

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