

The role of financial globalization



Main findings

- Financial globalization has accelerated since the early 1990s, with advanced countries investing financial assets in international markets amounting to several times their GDP. However, despite these substantial capital flows around the globe, financial globalization has failed to improve global productivity or employment growth. This stands in stark contrast to the benefits brought by domestic financial development.
- Moreover, despite accelerating financial globalization, less developed economies are not receiving their share of global savings. On the contrary, savings continue to flow from less to more developed economies, in contrast with theoretical predictions (the “Lucas paradox”). The presumption is that this may have to do with a lack of domestic financial market development, with adverse effects on the rates of return necessary to attract international investors and to prevent capital outflows of excess savings.
- Partly through the lack of proper regulation or an adequate supervisory framework, the frequency of financial crises has increased in both developed and emerging economies as a consequence of financial globalization. Worldwide, systemic banking crises have been 10 times more likely throughout the 1990s than during the late 1970s, which was hardly a period of calm economic activity. Such increased instability has come at a steep cost to inequality, as low-income households have been particularly affected by repeated boom-bust cycles. There is also evidence offered in this chapter that financial globalization is associated with higher unemployment. From a longer-term perspective, however, and at least as regards economic growth, the benefits of financial liberalization outweigh the costs of crises.
- Financial globalization has also led to a depression of the share of wages in GDP, reinforcing the downward trend recorded in most countries, as documented in Chapter 1. This effect is over and above any trend decline in the wage share that may have resulted from sectoral shifts, rising labour demand elasticities from trade openness or changes in labour market regulations and institutions. There is empirical evidence that financial globalization has led to an increase in income inequality,

owing both to a trend increase in financial assets (relative to GDP) and to a growing incidence of crises.

- Financial liberalization has had a disciplining effect on macroeconomic policies in both developed and emerging countries, although it has also led to a reduction in the margin for redistributive policies, as discussed in detail in Chapter 5. However, certain countries – in particular in Northern Europe – have demonstrated that it is possible to build complementarities between strong and well-designed welfare policies, on the one hand, and a competitive economy, on the other. In this way, the threat to redistribution policies posed by financial globalization is reduced.
- Developments in corporate governance mechanisms have led to an increasing use of performance-related pay systems for executive managers and directors. Nevertheless, empirical studies show that such systems have only a very moderate effect, if any, on company performance. Moreover, wide variations exist, with some countries displaying virtually no relation between performance-related pay and company profits. This suggests that managers are in a dominant wage-bargaining position with respect to company owners, partly as a result of institutional flaws.

Introduction

Trade liberalization, and its impact on economic growth, employment and inequality, has come under considerable scrutiny in recent years, but much less attention has been paid to the effect of financial market liberalization.¹ Now that the recent financial market turmoil in the United States has turned into the “first global financial crisis of the twenty-first century” (Felton and Reinhart, 2008), however, the labour market fall-out from such crises deserves renewed interest. The spillover of US financial market stress to other developed and emerging markets, in the form of interest rate hikes and the loss of liquidity, has demonstrated yet again that events in international financial markets can have a substantial impact on domestic economic and social development, with adverse consequences for employment growth and income opportunities. This chapter presents a review of the existing evidence, with a particular focus on the impact of financial liberalization on growth, employment creation and income inequality.

In theory, financial liberalization and the free allocation of global capital flows should generate substantial macroeconomic benefits for both capital exporters and recipient countries. Global trend productivity and employment are believed to grow faster, thereby lifting less developed countries out of poverty and helping to maintain (or further improve) living standards in the developed world. Low-income households are expected to benefit in particular, with the result that both global and within-country inequality are decreased. It has been suggested that financial globalization can both boost average per capita income and – potentially – lower income and wealth inequality in the following three ways:

- It can provide low-income countries with access to capital and help to improve the allocation of funds. It should also make it easier for low-income households to access the capital market and thereby lower income inequality within countries.

1. Financial liberalization refers to de jure measures aimed at both international financial markets (the removal of restrictions on capital import and export – “capital account opening” and exchange restrictions) and domestic capital markets (the removal of interest rate freezes or credit controls, as opposed to financial globalization, which refers to the de facto development of international capital flows. Financial openness refers to the de facto openness of the capital account (free entry and exit of capital flows to and from abroad).

- By imposing discipline on governments, it can improve macroeconomic policy-making and encourage the implementation of pro-growth reforms. This would improve income prospects across the board but would be particularly beneficial for low-income households (“pro-poor growth”).
- By strengthening corporate governance (for instance, through a more competitive market for corporate control), the argument goes, financial globalization helps to put capital flows to the most efficient and productive use and ensure that executives are performing at their best. This improves the business environment in both emerging and developed countries.

The experience of the past two decades has, however, shed significant doubt on whether these benefits have materialized. Trend productivity growth rates have accelerated – but not necessarily in the countries that opened their capital accounts the widest. Regular boom-bust cycles have wiped out earlier income gains to a large extent – mainly in middle-income countries – despite a global trend towards less volatility in economic activity. Low-income households do not seem to have benefited from improved access to financial markets to insure themselves against shocks. As a consequence, global inequality has, at best, remained constant, while inequality within countries seems to be rising, regardless of their level of economic development (see Chapter 1).

This chapter reviews the empirical evidence for the macroeconomic effects of financial globalization and discusses why several of the expected benefits have failed to materialize, in terms of both long-term economic growth and the vulnerability of low-income households. The indirect effects that financial liberalization may have on inequality are discussed in the light of its impact on domestic policy-making. Lastly, one specific dimension of financial globalization, namely the spread of modern corporate governance practices, is considered, and in particular the links between executive pay and performance.

A. Development of financial globalization and wealth inequality

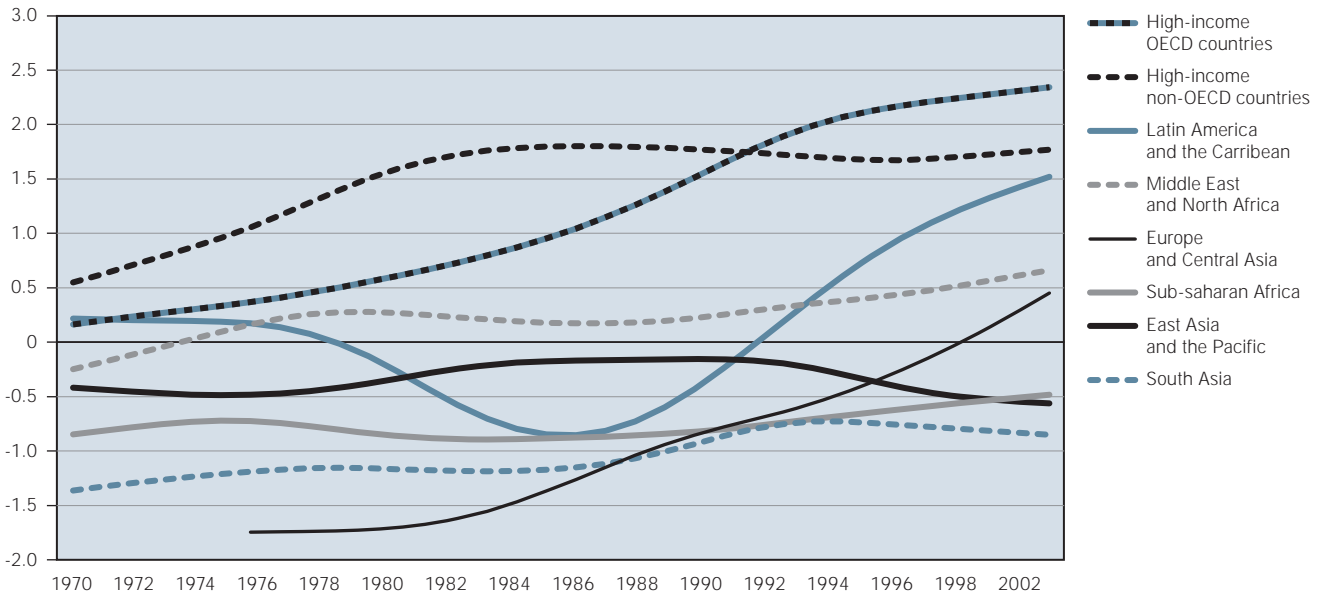
Uneven progress in opening capital accounts...

The opening of capital accounts has progressed unevenly across the globe (see fig. 2.1). The developed economies of Asia were among the first to embark on financial liberalization but gradually re-introduced restrictions, in particular in the aftermath of the Asian financial crisis in 1997. High-income OECD countries have opened their capital accounts more gradually but eventually became the most financially open economies around the globe. Most other regions have shown only very limited efforts to follow suit, although, among these, Latin American countries have recently progressed the most. There are also significant intra-regional differences in financial liberalization. Except for high-income OECD countries – where there has been a convergence of policies – most of the countries with the least open capital accounts have not adopted any financial liberalization measures.

...has led to uneven acceleration of financial globalization...

Like financial liberalization, financial globalization has progressed unevenly across the world over the past two decades (fig. 2.2). The sum of gross financial assets and liabilities exceeded the (nominal) GDP of High-income OECD countries by 200 per cent at the end of the 1990s, whereas it had been at par with GDP at the end of the 1980s. An acceleration of financial market development has also been observed in High-income Non-OECD countries and East Asia and the Pacific. There has been no such acceleration in

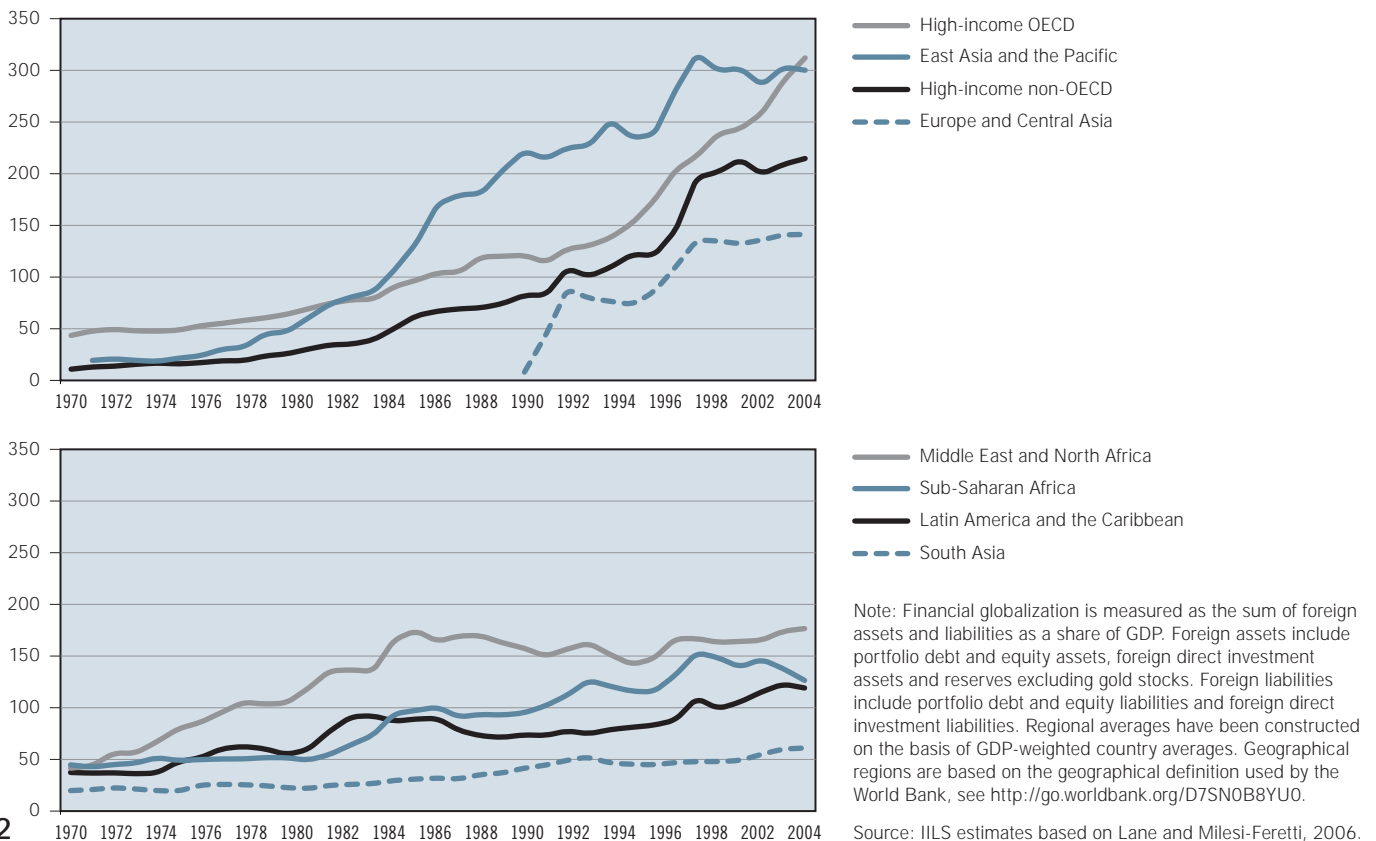
Figure 2.1. De jure measures of capital account opening



The figure displays the country median of a de-jure measure of capital account openness for eight world regions (based on the geographical definition used by the World Bank, see <http://go.worldbank.org/D7SN0B8YU0>). The measure is based on the first principal component of (i) a variable indicating the presence of multiple exchange rates, (ii) a variable indicating restrictions on current account transactions, (iii) a variable indicating restrictions on capital account transactions and (iv) a variable indicating the requirement of the surrender of export proceeds. All variables are based on information contained in the IMF Annual Report on Exchange Arrangements and Exchange Restrictions.

Source: ILS estimates based on Chinn and Ito (2007).

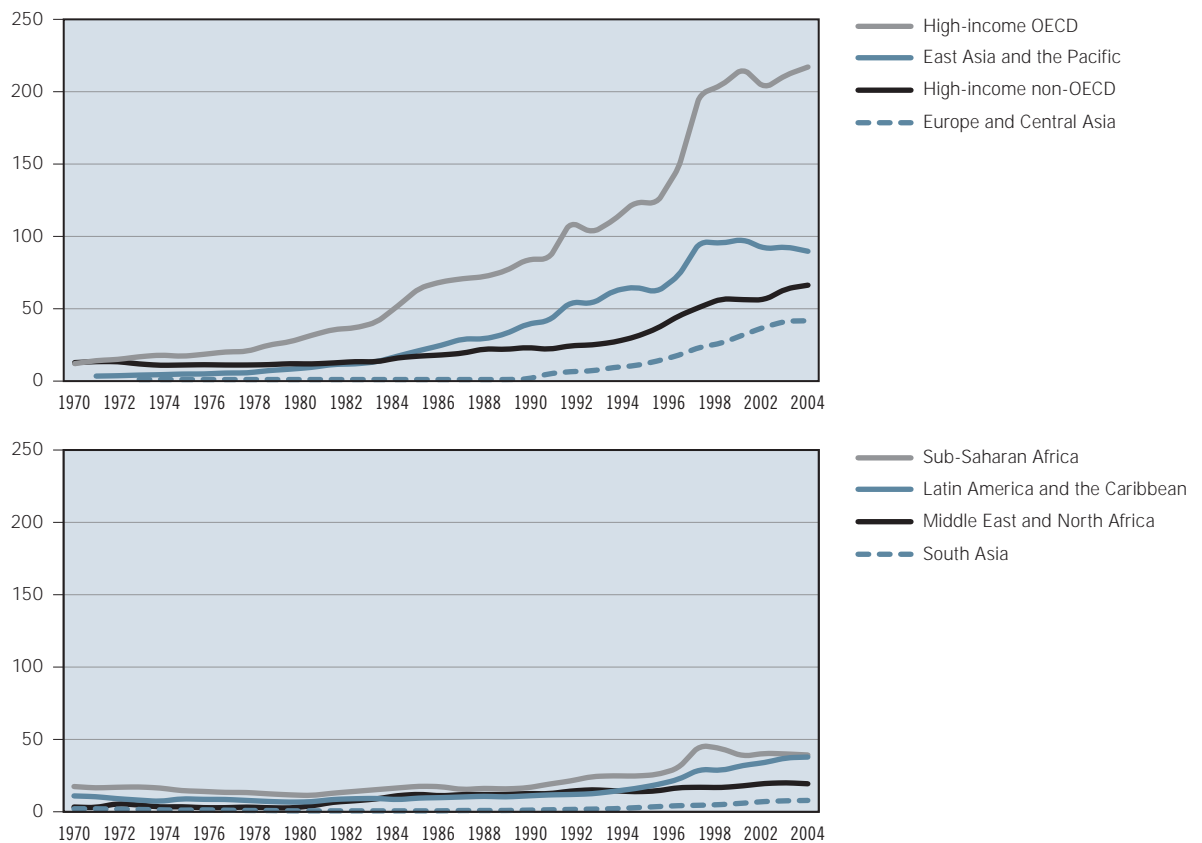
Figure 2.2. Financial globalization in seven world regions (% of GDP)



Note: Financial globalization is measured as the sum of foreign assets and liabilities as a share of GDP. Foreign assets include portfolio debt and equity assets, foreign direct investment assets and reserves excluding gold stocks. Foreign liabilities include portfolio debt and equity liabilities and foreign direct investment liabilities. Regional averages have been constructed on the basis of GDP-weighted country averages. Geographical regions are based on the geographical definition used by the World Bank, see <http://go.worldbank.org/D7SN0B8YU0>.

Source: ILS estimates based on Lane and Milesi-Ferretti, 2006.

Figure 2.3. Foreign direct investment in seven world regions (% of GDP)



Note: Financial globalization is measured as the sum of foreign assets and liabilities as a share of GDP. Foreign assets include portfolio debt and equity assets, foreign direct investment assets and reserves excluding gold stocks. Foreign liabilities include portfolio debt and equity liabilities and foreign direct investment liabilities. Regional averages have been constructed on the basis of GDP-weighted country averages. Geographical regions are based on the geographical definition used by the World Bank, see <http://go.worldbank.org/D7SN0B8YU0>.

Source: ILS estimates based on Lane and Milesi-Feretti, 2006.

other regions, in particular in the emerging markets of South Asia and Latin America; and their financial market openness has barely changed over the past decade.

The picture changes only slightly when foreign direct investment (FDI) is considered (fig. 2.3). High-income Non-OECD countries again stand out as the main force behind financial globalization, followed by East Asia and High-income OECD countries. Europe and Central Asia also benefited from a rapid increase in investment flows following the widespread privatization after the fall of the communist regimes. More recently, Sub-Saharan Africa and Latin America and the Caribbean also seem to have gained ground in integrating with global financial markets, with the rapid inflow of foreign capital in African countries being expected to accelerate further over the coming years, partly as a result of large investments in the mining and extracting industries (Nellor, 2008). There was no such increase in FDI in Middle Eastern and North African countries or – notably – in South Asian economies.

...and has not helped to reduce wealth inequality

The different rates of development of financial openness have so far prevented a convergence of wealth inequalities between developed and emerging countries (table 2.1). Indeed, despite the potential of capital flows to alleviate borrowing constraints for low-income households, their rise has been so disjointed, geographically speaking, that they have not yet

Table 2.1. Wealth inequality in selected countries

	Wealth Gini (2000)	Income Gini	Year
Argentina	74.0	50.1	2005
Australia	62.2	31.2	2003
Bangladesh	65.8	33.5	1996
Brazil	78.3	56.6	2004
Canada	66.3	31.5	2000
China	55.0	44.9	2003
France	73.0	27.8	2000
Germany	67.1	31.1	2004
India	66.9	36.5	1997
Indonesia	76.3	39.6	1996
Italy	60.9	33.3	2000
Japan	54.7	31.9	1998
Republic of Korea	57.9	37.2	1998
Mexico	74.8	49.9	2004
Nigeria	73.5	52.2	1996
Pakistan	69.7	39.8	1996
Spain	56.5	33.6	2000
Taiwan (China)	65.4	33.9	2003
Thailand	70.9	42.7	2001
United States	80.1	46.4	2004
Viet Nam	68.0	37.3	1998

Source: Davies et al., 2008; World Bank, 2008.

affected wealth inequalities in developing countries, which remain – on average – higher than in developed economies. Moreover, global wealth inequality as measured by the global Gini coefficient stands at 89.2, substantially higher than most measures for global income inequality (Anand and Segal, 2008) and higher than would be suggested by the relationship between wealth and income inequality within developed countries. In short, the current dynamics of financial globalization have prevented a further convergence of wealth both across and within countries, with income inequality in low-income countries remaining unaffected by financial openness. This is in marked contrast with the sanguine predictions of some proponents of financial globalization.

B. Financial markets and pro-poor growth

Financial liberalization has the potential to improve trend growth...

Standard growth theory predicts that financial liberalization helps to accelerate growth in low-income countries by raising domestic savings and giving access to global capital flows (Fisher, 2003; Obstfeld, 1998; Summers, 2000) and at the same time developing the domestic financial market, which is itself conducive to the more efficient allocation of resources and higher growth (King and Levine, 1993). The increase in available funds also brings interest rates down in emerging economies, thereby fostering investment and employment growth, and helps to alleviate poverty and reduce between-country income inequality by lowering the borrowing constraints of the households with the least access

to finance. Moreover, with improved opportunities for international risk-sharing, countries may be better able to exploit gains from specialization in international trade (Acemoglu and Zilibotti, 1997; Kalemli-Özcan, Sørensen and Yosha, 2001). Lastly, additional, indirect benefits may be expected from the transfer of technology and knowledge that comes with foreign direct investment, which improves total factor productivity (Bonfiglioli, 2007; Kose, Prasad and Terrones, 2008).

The least controversial of these claims relates to a basic aspect of financial liberalization, that is, the liberalization of the domestic financial system. This typically involves dismantling systems of credit rationing and interest rates controls. The case for such liberalization was made in the early 1970s in the literature on development economics (McKinnon, 1973; Shaw, 1973). It was argued, that in the context of the import substitution strategies that were then prevalent in most developing countries, controls that repressed the growth of the financial system lowered growth and exacerbated general inefficiency in the allocation of resources. They also increased inequality in the distribution of income by supporting increased industrial concentration and limiting access to credit for enterprises that were not favoured by the economic planners. Removing these distortions, the argument went, would both increase economic growth and reduce income inequality.

A basic way in which this could be done is to lift ceilings on interest rates. A rise in interest rates should increase the supply of domestic savings and screen out inefficient investments that had previously been artificially promoted. Although there were some concerns that a rise in interest rates might not lead to the expected increase in growth rates (because of its negative effect on the cost of capital and on the level of effective demand), the macroeconomic case for domestic financial liberalization was, and still is, generally accepted. Even critics of external financial liberalization such as Rodrik and Subramanian (2008) see special benefits in domestic financial liberalization that avoids the costs of external liberalization. For example, domestic financial liberalization, unlike external liberalization, tends to lower the exchange rate, because the increase in domestic saving reduces the need to rely on foreign borrowing. Such an exchange rate outcome is favourable to the growth of the tradeables sector, the main potential engine of growth.

Domestic financial liberalization and development are also essential if countries are to take advantage of their integration into the world economy. Weak financial development and distorted saving incentives at home, combined with substantial gains in international market shares, will lead to increasing current account surpluses. This, in turn, means that low-income countries become exporters of capital to high-income countries. Indeed, the fact is that capital tends to flow from capital-poor to capital-rich countries – the Lucas paradox – in contrast to theoretical predictions. It is only recently, however, that the link between capital account surpluses and (domestic) financial market development has been explicitly recognized (Mendoza, Quadrini and Rios-Rull, 2003). Empirical analysis on the basis of this line of research shows that such a link holds quite consistently, even when account is taken of various other factors that may contribute to current account surpluses.² Another interpretation of these results is that financial globalization without proper development of domestic financial markets is likely to increase global wealth and income inequality. It may also increase within-country inequality to the extent that those with the least access to credit markets are likely to be even more credit-constrained following massive capital outflows. On the other hand, those with access to international financial markets – in most cases high-income individuals and international corporations – benefit fully from investment opportunities outside their home country. Whether the emergence of large sovereign wealth funds will resolve these global current account imbalances – as some have suggested (Beck and Fidora, 2008) – remains an open question, as long as the underlying structural problems in capital-constrained countries are not addressed (see box 2.1).

2. See the background paper prepared for this chapter for more details (Ernst and Escudero, 2008).

Box 2.1. Sovereign wealth funds and global capital flows

Fuelled by the recent surge in the price of oil and other commodities, a group of resource-rich emerging market economies has managed to build up substantial financial funds, often managed by sovereign wealth funds (SWFs). These SWFs are set up primarily to prevent that temporary surges in world market prices for a country's main export commodities lead to overheating, exchange rate appreciation or rapid, unsustainable increases in government expenditure. Although SWFs have been around for several decades, the earliest example being the Kuwait Investment Board set up in 1953, it is only recently that they have attracted more widespread interest, in view of both their impact on capital market developments in individual countries and their effect on global capital flows. In particular, their (presumed) lack of transparency over their investment strategies and the potential consequences of such financial power for global stability have raised concern and caused policy-makers to consider the possibility of intervention.

The optimistic view has it that, given the size of SWFs, they need to make diversified investments on global capital markets, which might correct some of the current account imbalances that have built up over the past decade (Beck and Fidora, 2008). Such a correction would undoubtedly improve the stability of the international financial system. As discussed in the text, however, these imbalances seem to be due to investors' perceptions about distortions on individual financial markets and the relative returns they can receive by investing in different countries. As long as these distortions are not removed, or at least reduced to the low levels as found in advanced economies, SWFs are unlikely to play an important role in equilibrating global current account imbalances.

A more pessimistic outlook on SWFs relates to their financial importance and the potential for political interference in their investment strategies. This is particularly likely in resource-rich countries that suffer from weak governance and might be tempted to use the wealth of the funds to promote their own international political agenda. More importantly, the sheer size of SWFs – often representing several hundred per cent of the GDP of their countries of origin (Mitchell, Piggott and Kumru, 2008) – runs the risk of influencing the market. In particular, in more volatile times, there is a danger that the investment behaviour of such powerful bodies will be used as a public signal for other investors, with the potential to lead to sudden stops and capital flow reversals.

...but benefits have been slow to materialize...

Despite these theoretical benefits of financial liberalization for trend growth and inequality, empirical studies have so far produced mixed evidence, particularly regarding the impact of financial globalization on productivity and employment growth. A recent review of the literature by the IMF concluded that “[o]ur reading of this large literature based on aggregate data is that it remains difficult to find robust evidence that financial integration systematically increases growth, once other determinants are controlled for” (Kose et al., 2006). In particular, the level of financial market openness does not seem to play any particular role, whereas there is some indication that the change in financial integration could be a driver of productivity acceleration and employment growth. This debate is by no means over (see Henry, 2007; Rodrik and Subramanian, 2008), but it is sufficient to note for the purposes of this report that it is far from an accepted fact that financial openness increases growth. Instead, there is intriguing counter-evidence from a number of studies that the countries that have grown fastest have relied least on foreign capital (Gourinchas and Jeanne, 2007; Prasad, Rajan and Subramanian, 2007).

Part of the difficulty in finding a definite relationship between financial globalization and growth may lie in the fact that financial market openness interacts with the overall regulatory environment in any particular country. A supporting business environment with efficient governance, productive industrial relations and predictable labour regulation helps foreign investors to identify business opportunities quickly and channel funds towards their most productive use (Mishkin, 2006). On the other hand, the recapitalization of firms through portfolio flows on equity and corporate bond markets may suffer from inadequate corporate governance institutions, badly designed product market regulations

or anti-competitive behaviour by executive directors and special interest groups. In such situations, the over-hasty opening of the capital account, accompanied by loose prudential regulation and distortions in the domestic financial system, has been held responsible for many of the recent difficulties faced by emerging economies in benefiting from financial globalization (Obstfeld, 2007).

Consistent with the mixed evidence found in earlier studies, this report finds conflicting effects of financial market liberalization on labour market outcomes.³ Financial globalization could have been beneficial for employment growth. Domestic financial liberalization, however, has contributed to a rise in the unemployment rate, partly as a result of increased turbulence on the labour market. In comparison with trade liberalization the average net effect of financial market liberalization (that is, financial globalization and domestic financial liberalization combined) appears to be modest. Moreover, it should be noted that the evidence reveals only the average impact of financial globalization for large country groups over a comparatively longer time period. Individual countries, at specific (short) periods, may not have been affected by financial market liberalization as much as suggested by these estimates.

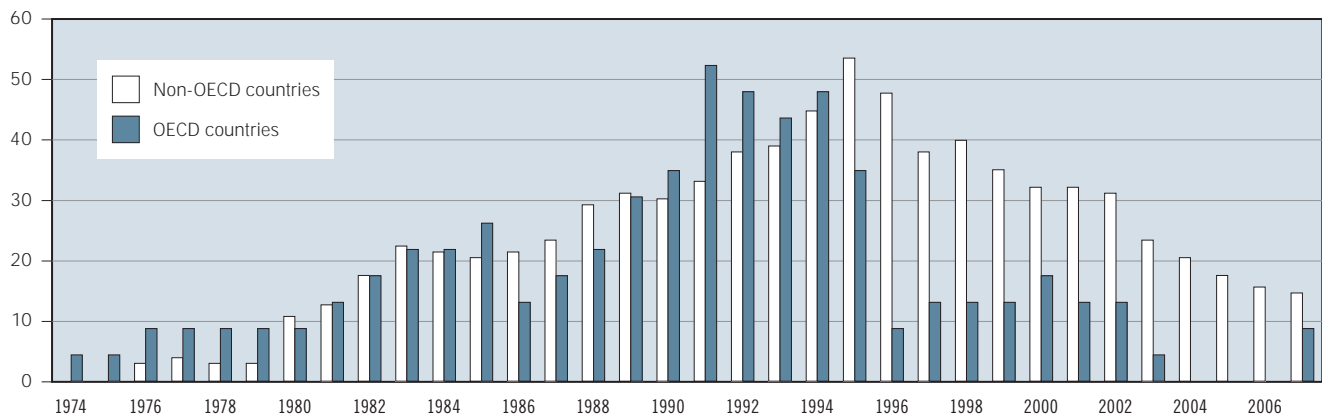
...and increased the vulnerability of low-income countries to shocks

The increasing frequency of systemic financial crises may have been another reason why the benefits of financial globalization, if any, appear so far to have been limited. In particular, the vulnerability of low-income households in such crises may have largely wiped out earlier gains in the form of reduced income inequality and higher growth. As mentioned above, the theory suggests that financial globalization and access to global capital markets can increase the potential for international risk-sharing, thereby enabling low-income countries and households to mitigate the economic effects of fluctuations in their current account. However, financial liberalization may fail to deliver improvements in living standards if the vulnerability of low-income households and the volatility of output, employment and consumption subsequently increase. There are, indeed, signs that both developed and emerging economies have experienced more frequent financial market crises in recent years, which have increased consumption and employment volatility (Kose et al. 2006). Indeed, data assembled by Laeven and Valencia (2008) show that the incidence of banking crises increased in line with financial globalization worldwide and remained high throughout much of the 1990s, especially in emerging economies (fig. 2.4). A more detailed analysis of the underlying factors suggests that an increase in vulnerability as a result of financial liberalization is particularly likely in emerging economies with relatively fragile financial systems. Developed economies with consolidated financial systems offering a wide range of financial products to insure against a multitude of risks may already take full advantage of their financial integration by experiencing more stable consumption and employment.

A rise in a country's vulnerability to shocks may be, in part, related to its failure to strengthen its domestic financial system prior to liberalization, whatever its level of development. The risk of a financial market crisis is not inherent to financial liberalization, even though the two are closely related, as recently shown by Reinhart and Rogoff (2008). Rather, institutional weaknesses in the financial system or the prudential regulation and supervision regime can be held accountable. Inadequate supervision when opening financial markets does not affect only emerging economies, as the recent burst of the sub-prime bubble has demonstrated. Nevertheless, since the vulnerability of low-income households is higher in emerging economies, both inequality and poverty levels typically take a harder hit at the onset of a financial market crisis in such countries than in more developed ones. This occurs through several mutually reinforcing channels.

3. See Ernst and Escudero (2008) for details.

Figure 2.4. Frequency of banking crises, systemic or otherwise, in OECD countries and the rest of the world (%)



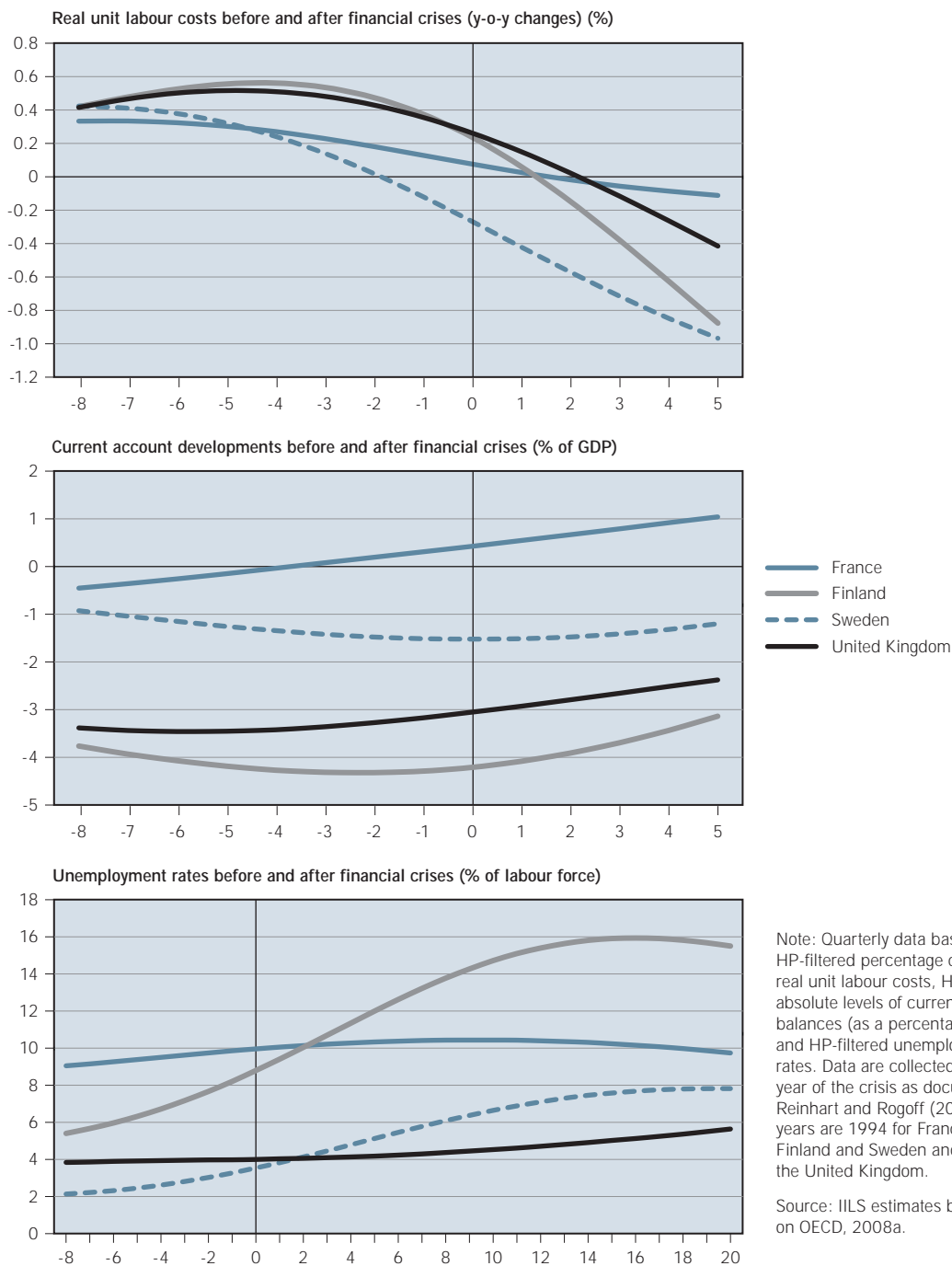
Source: ILS estimates based on Laeven and Valencia, 2008.

The rise in real interest rates that typically occurs as a result of attempts to stem capital outflows at the onset of a crisis tends to favour high-income over low-income households, as central banks try to stabilize the external value of the currency. Similarly, the rise in inflation often associated with financial crises tends to have a negative effect on income distribution and poverty. Real wages decline, and so does the wage share in national income (Diwan, 2001). These effects are over and above the negative impact of the sharp rise in unemployment that occurs at the onset of a serious financial crisis (fig. 2.5). Moreover, the negative labour market consequences of such crises have a particularly long-lasting impact, sometimes reversed only several years later.

These negative primary economic effects of financial crises tend to be reinforced by the effects of policies adopted in their wake. Contractionary fiscal policies usually have a negative impact on income distribution and poverty. Public expenditure on social services such as health and education that are important for the welfare of low-income households is often reduced. Expenditure on agricultural extension services and credit, and on other anti-poverty programmes, suffer a similar fate. In addition, programmes to bail out the country's financial system typically have a regressive effect on income inequality. Large depositors, who are also usually better connected and better informed, benefit most, while small depositors are rarely adequately protected. The same goes for small firms, which have less access to credit markets in the event of financial difficulties than larger firms, which are "too big to fail".

As mentioned above, it is important to note that the negative effects of financial crises on the labour market and on distribution often persist well into the period of economic recovery. The loss of property and productive assets as a result of foreclosure or distress sales is not immediately rectified by an economy's overall recovery after a crisis. Similarly, there are longer-term negative consequences for the low-income households from crisis-induced developments such as the withdrawal of children from school, malnutrition, increased indebtedness and prolonged unemployment. Such negative distributional consequences have to be set against the possible long-term trend improvements brought about by boom-bust cycles. There is evidence that sudden stops following periods of rapid economic expansion are characteristic of countries that undergo a fundamental transformation and development of their financial sector, helping to alleviate firms' and households' borrowing constraints (Rancière, Tornell and Westermann, 2008), with a resulting trade-off between higher long-term growth and lower inequality (fig. 2.6). In particular, the acceleration of credit growth seems to fuel both trend GDP per capita

Figure 2.5. Development of current accounts and wage share during financial crises in four countries



growth and inequality. However, the theory that regular boom-bust cycles produce a cleansing effect, by shedding inefficient production units, receives only modest support in our empirical analysis. Indeed, an estimate of the impact of the frequency of crises in the banking sector on both inequality and trend GDP per capita growth indicates that the effect is statistically significant but economically negligible. Rather, it seems that the development of the financial sector and its positive contribution to employment creation, as identified above, has a more substantial effect, resulting in the trade-off between inequality and long-term growth, mentioned above. Such an effect is, however, felt only in the longer term. For individual countries, at the moment when a crisis hits, these costs may be substantial (see box 2.2).

Box 2.2. Cost of financial crises in individual countries – the Asian crisis

The chapter argues that, from a longer-term perspective, the benefits of financial development outweigh its costs, in terms of both inequality and job creation. In individual countries that have been hit by a financial crisis, the temporary costs can be substantial with long-lasting consequences that may wear off only in the very long run.

Following the Asian crisis, GDP contracted on average by 7.7 per cent between 1997 and 1998 in the five hardest hit countries (Indonesia, Malaysia, the Philippines, the Republic of Korea, Thailand) and took between two and seven years to recover to pre-crisis levels. With the notable exception of Indonesia, labour force participation rates declined by up to 2 per cent but recovered in most cases to previous levels after three to eight years. More importantly, (formal) employment rates fell by up to 3.1 per cent and took between five to 10 years to return to pre-1997 levels. No international comparison exists as to the impact of the Asian crisis on income inequality and poverty, but data for Indonesia – admittedly the country that had been hit the hardest – suggest that the incidence of poverty took around seven years to return to pre-crisis levels (OECD, 2008b). This has to be set against the fact that, before the financial crisis, poverty had fallen continuously by around 1 percentage point per year. Cumulatively, therefore, the gains in poverty reduction have still not caught up with the increase in poverty due to the crisis.

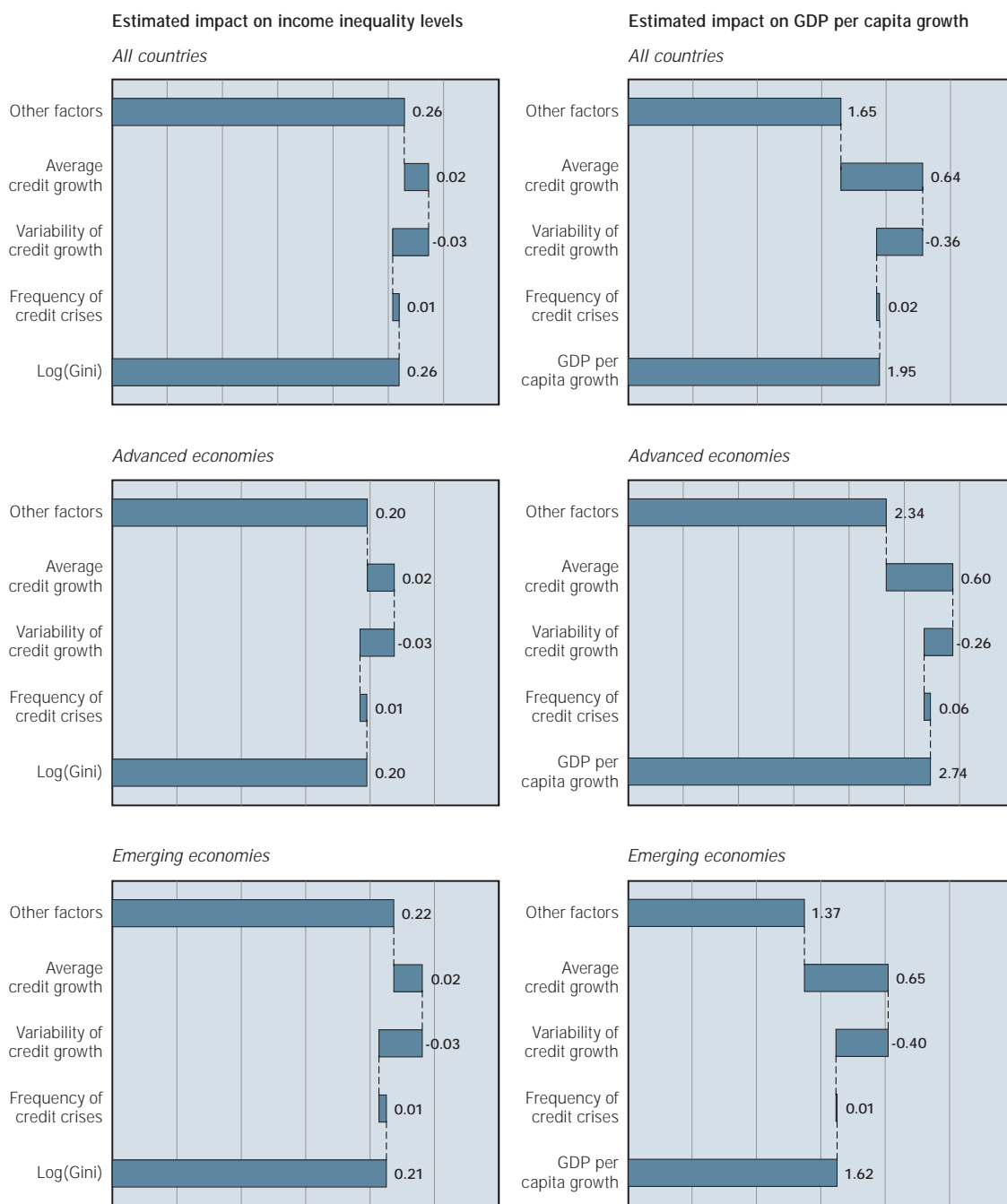
In sum, the effects of a financial crisis have proved in the past to cause substantial damage that takes several years to wear off. The differences in the speed with which countries recover show, however, that policies can and do have an effect on a country's ability to cope. The implementation of proper labour and product market policies to help countries adjust quickly in the aftermath of a shock therefore remains an important way of enhancing the benefits of financial globalization and limiting its costs (Duval, Elmeskov and Vogel, 2007).

C. Financial globalization, union bargaining power and the wage share

Financial liberalization has contributed significantly to the spectacular rise in the income of the top 1 per cent of income earners in the United States, a major proportion of which is finance-derived. This includes not only the income of rentiers but also that of a growing number of people that are nominally classified as employees, such as investment bankers, CEOs with stock options, financial advisers and analysts, and lawyers and accountants in the financial sector. At the same time, regulatory failures and supervisory negligence have led to financial excesses, with the burden of adjustment borne by the less well-off and the average tax-payer, as is the case at present. For example, the sub-prime borrowers in mortgage markets are at the lowest end of the income spectrum and risk crippling losses from falling property prices and repossession of their homes. In the case of the United States, the crisis has caused a significant reversal of the gains of earlier programmes that aimed at increasing home-ownership among low-income households. In some cases whole communities have been affected, suffering not only the loss of their homes but also increased crime and declining local tax revenues and public services.

Another side effect of financial liberalization that has contributed to growing inequality in some industrialized countries is the even greater importance attached to “shareholder value” maximization and to private equity funds in corporate management. The demand for higher dividend payouts by active shareholders has made managers more resistant to claims for wage increases than in the past, while the threat of outsourcing and downsizing has weakened the bargaining position of workers (Choi, 2001). Meanwhile, the increasing role of private equity funds that are not subject to the regulatory controls faced by public companies has led to greater “short-termism” and increased risk in corporate management. In their bid to satisfy shareholders who seek short-term profit maximization, managers are no longer able to share the benefits of long-term cooperation with employees that would result in higher productivity and stronger investment in

Figure 2.6. Impact of financial development and crises on inequality and growth



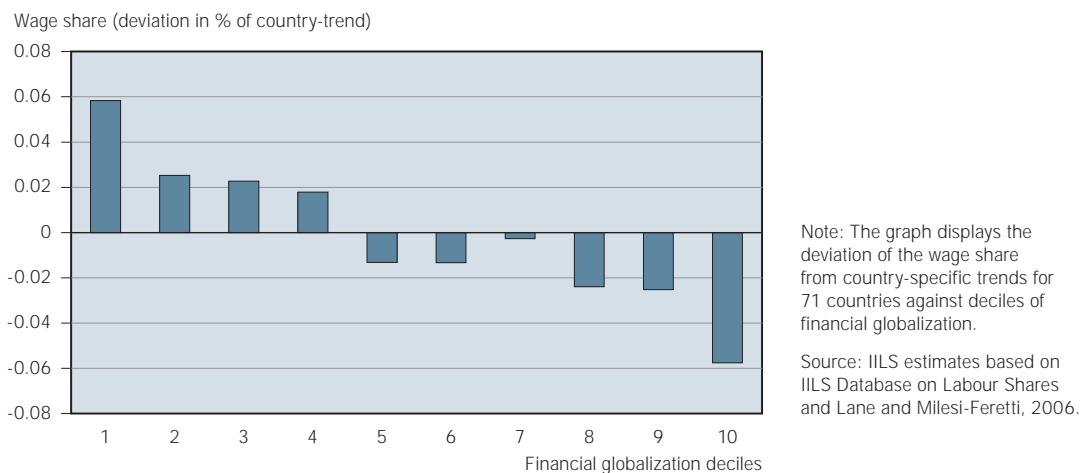
Note: The contributions are based on FGLS estimates, including regional dummies (see Appendix A for a discussion of the methodology).

Source: ILS estimates.

firm-specific capital (Ernst, Amable and Palombarini 2005; Pagano and Volpin, 2005). Rather, they align themselves with their shareholders by selecting investment projects that promise tangible profits over the short term and restrict incentives established to reward employees over the long term.

This trend, which is caused by financial globalization, has been detrimental to workers' wages and employment security and has in some cases led to the unnecessary dismantling of firm-specific assets, such as organizational capital. The effect on the wage

Figure 2.7. Financial globalization and the evolution of the wage share



share has also been quite sizeable, with an estimated elasticity of around 0.3 (in other words, an increase of financial openness by 1 percentage point reduces the labour income share by 0.3 percentage points). This contrasts with evidence on the effects of openness to trade, offshoring and immigration on the wage share (Jaumotte and Tytell, 2007), which seem to have had a smaller impact than other external factors such as (skill-biased) technological change. In sum, over and above the downward trend in the wage share that may have been induced by sectoral shifts, rising labour demand elasticities or changes in labour market regulations and institutions, financial globalization has had a distinct effect on the labour income share in both developed and emerging economies (fig. 2.7).

Not only has workers' bargaining position been weakened, but, in addition the benefits of financial liberalization may be distributed unequally, thereby increasing within-country inequality. Indeed, the rapid increase in foreign direct investment observed in emerging economies in particular may have contributed to a global increase in the skill premium for high-skilled workers (IMF, 2007), despite the potential of trade openness to reduce economic inequality by improving opportunities on the labour market. Through the transfer of technology that creates particular employment opportunities for high-skilled workers foreign direct investment causes inequality to increase as the upper tail of the wage distribution moves further eastwards.

D. Financial globalization and the convergence of capitalisms

Financial liberalization also has indirect effects on macroeconomic performance and income inequality, by imposing additional constraints on the ability of governments to pursue redistributive policies. The increased mobility of capital further restricts still the extent to which it can be taxed without provoking the relocation of production and reversing capital flows. It also reduces the bargaining strength of workers and increases the temptation for governments to shift tax burdens on to this relatively immobile section of society. Analysis presented in Chapter 5 suggests that this process is probably under way already. On a more positive note, however, risky macroeconomic policies that result in overvalued exchange rates and rampant inflation, with adverse implications for inequality, are becoming much more costly for governments. It would therefore seem that the effects of financial liberalization on inequality are mixed, when such indirect factors are taken into account.

52 In many emerging countries, low-income households can make significant gains from the macroeconomic discipline imposed on their governments. High inflation hits

Table 2.2. Redistribution: inequality before and after taxes

	Market income inequality	Inequality after transfers	Disposable income inequality (after transfers and taxes)
Argentina	50.0	48.6	48.1
Australia	46.0	na	31.2
Austria	37.5	30.4	24.8
Belgium	46.5	36.4	29.2
Bolivia	56.0	54.1	54.3
Brazil	47.2	45.8	45.6
Canada	42.9	na	31.5
Chile	56.8	53.3	52.2
Denmark	48.6	34.9	28.5
Finland	49.3	36.3	31.6
France	42.0	34.5	30.9
Germany	43.0	33.3	28.2
Greece	47.4	40.0	36.3
Ireland	53.1	38.9	33.8
Italy	47.5	41.0	37.4
Luxembourg	41.3	30.1	23.8
Mexico	51.0	50.3	49.4
Netherlands	38.7	29.7	26.1
Norway	37.2	na	23.1
Peru	48.6	48.8	47.9
Portugal	49.4	43.0	38.1
Spain	46.8	39.6	34.8
Sweden	45.2	32.8	29.0
Switzerland	39.2	na	27.4
United Kingdom	52.3	38.8	34.3
United States	48.1	na	37.2

Note: na = not available.
Source: Mahler and Jesuit, 2006; OECD, 2008c.

low-income households particularly hard, as they spend most of their income on primary commodities, for which there are practically no alternatives (see Chapter 1, Appendix 1). Moreover, overvalued exchange rates (such as that of the Argentine peso before the 2001/2002 crisis) mainly benefit the middle- and high-income groups, easing their consumption of cheap imported goods, but hurt the employment prospects of low-income households in the exporting sector. This is important, because many low- and middle-income countries hardly redistribute to start with, in part because of the existence of a large informal sector (table 2.2). In such countries, more stable and predictable macroeconomic policies will have beneficial effects not only on trend growth but also on inequality. It should be stressed, however, that some measures dictated by financial liberalization, which are meant to address lax macroeconomic policies, come at a high cost, in terms of both economic growth and inequality (see box 2.3). More importantly, they usually do not address the underlying structural problem, namely huge income inequalities (see Chapter 1).

Financial globalization is also said to put pressure on national policy-makers to adjust their structural policies to favour capital owners. Over and above sound macroeconomic policies and a lower tax burden for richer households – a topic discussed in Chapter 5 – such adjustments also involve implementing specific accounting rules and supervisory standards and striking a balance between creditor and equity owner rights. Having similar standards across countries facilitates the activities of global investment

Box 2.3. Importing macroeconomic discipline: Economic and social costs and benefits in Argentina and Ecuador

Financial and currency crises have hit Latin American countries at regular intervals. In order to respond to the resulting threat to macroeconomic stability, several countries in the region have, at times, sought to import monetary stability through various forms of fixed exchange rate regimes. Some have experimented with linking the domestic currency to the US dollar or to a basket of internationally recognized currencies, while few others have taken the more radical step of replacing the domestic currency by the US dollar altogether (among them El Salvador, Panama and – more recently – Ecuador). Although it involves the loss of monetary sovereignty, dollarization avoids some of the negative consequences that fixed exchange rates may have in terms of risky international speculation and thus contributes to macroeconomic stability. This box discusses the Argentine and Ecuadorian experiences with these two strategies to foster currency stability and compares the costs and benefits of the two approaches.

Argentina: the failure of the Convertibility Plan

Argentina introduced a fixed peg (the “Convertibility Plan”) in 1991 as a reaction to macroeconomic instability that had caused 15 years of economic stagnation and inflation. The Plan included a requirement for the Central Bank to ensure that every peso issued was matched by a US dollar in its accounts and structural reforms to strengthen the domestic financial sector, open the economy to international capital markets and boost microeconomic efficiency through trade liberalization and the privatization of state enterprises.

In its initial phase, the Plan successfully stabilized the economy, achieving a fast reduction of inflation and interest rates, which brought the misery index down by over 60 per cent (fig. B1).^a Output growth soared between 1992 and 2000, reaching 4.2 per cent per year, partly driven by strong export growth (5.1 per cent per year) and the favourable international financial environment. The number of households living below the poverty line fell in tandem with the misery index.

Signs of weakness first appeared during the Mexican crisis of 1995, when capital flows went into reverse gear, but it took the Asian and Russian crises to make the limitations of the Plan openly visible. By the end of 1998, Argentina was back into recession, mainly owing to an overvalued real exchange rate and a current account deficit of 3 per cent of GDP, which led to a rapid build-up of short-term foreign liabilities (“hot money”). Moreover, the increasing use of deficit spending to create economic stimulus and boost employment creation led to a steady rise in general government net debt, which fuelled concerns among both foreign and domestic investors regarding the credibility of the currency peg. In early 2002, after having lost 12 billion pesos in trying to stabilize the currency, the Central Bank was forced to abandon the peg. The Plan was repealed by Congress and the peso was allowed to float freely again.

The ensuing rapid capital outflow and run on the banks made the economic recession even worse (between 1999 and 2002 GDP per capita contracted by more than 21 per cent). Unemployment jumped from 15 per cent to 21 per cent over the four years of the crisis. More importantly, the level of absolute poverty increased from 2.6 per cent of the total population in 1998 to 8.4 per cent in 2003 (World Bank, 2008). Similarly, the incidence of poverty based on a measure indicating whether a household could afford a basket of basic commodities (the poverty gap) almost doubled in the first year after the peg had been abandoned (INDEC, 2008).

Most macroeconomic indicators have recovered since the end of the crisis and labour market outcomes have improved, with unemployment having returned to its previous levels. The financial sector has stabilized but lending activity lags behind pre-crisis levels, with loans still below 11 per cent of GDP, compared to 25 per cent of GDP in 1998 (EIU, 2006). Finally, inflation – the main reason for the Convertibility Plan – has returned as an important policy issue, reaching double figures in 2006.

^a The misery index measures the sum of inflation and unemployment rates.

Ecuador: mixed effects of dollarization

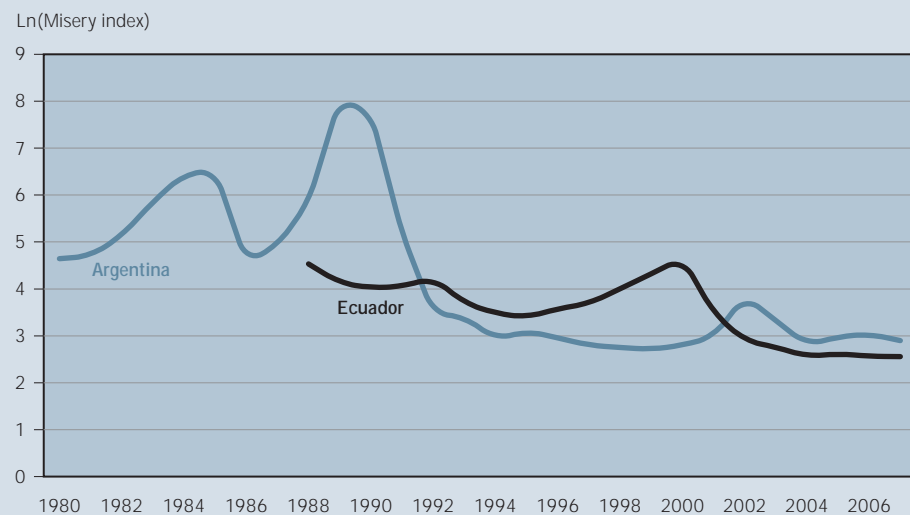
In Ecuador, policy-makers replaced the national currency (the sucre) by the dollar in 2001, in the aftermath of the 1999 financial crisis that had caused GDP to contract by 7 per cent, inflation to accelerate to over 50 per cent per year and the currency to depreciate by 200 per cent. Against the background of social unrest, a lack of congressional support for structural reform and the spectre of a run on the banks, dollarization brought immediate benefits by helping the macroeconomy to stabilize rapidly. The misery index fell by 45 per cent within 4 years (fig. 2.8).

Replacing the national currency by the dollar, however, caused the Ecuadorian government to lose revenues from seigniorage of around 7 per cent per year of GDP (Ecuador does not benefit from a seigniorage-sharing agreement with the United States). In addition, deposit insurance is now the responsibility of a government agency, with an annual budget of around 0.2 per cent of GDP, further rising fiscal costs of dollarization. It is issued with an unlimited guarantee (Demirgüç-Kunt et al., 2006), creating a moral hazard bias that may have caused this contingent liability to generate a substantial fiscal burden in case another banking crisis hits the economy.^b

More importantly, even though macroeconomic instability declined rapidly, real lending rates remain high and sovereign bond spreads are no lower than they were before the crisis period (and are still far higher than those observed in other Latin American countries). On the other hand, price competitiveness does not seem to have suffered from dollarization, as (non-oil) exports started to expand following a sharp contraction during the crisis, thus helping to reduce the (non-oil) current account deficit by 3 per cent between 2000 and 2005 (IMF, 2006).

So far, the benefits of dollarization have far outweighed its costs. Nevertheless, the macroeconomic environment needs to be strengthened further to lower the country's vulnerability to shocks. With only one policy instrument left, and against the background of a persistently high level of foreign debt, fiscal policies could play a more important role in helping to lower sovereign bond rates and improve financing conditions for domestic enterprises. This would further strengthen export growth securing the monetary base and could help bring down the unemployment rate, which is still high.

Figure 2.8. Misery index



Source: ILS estimates based on IMF, World Economic Outlook database, 2007

^b Since 2003, the guarantee has been restricted to 400% of GDP per capita, i.e. around \$6600.

funds, which lobby for ever greater uniformity across the globe. The introduction of the legal framework of the European public company and the evolution and convergence of prudential regulation regimes towards the Basel II accord may be seen as evidence of their success. More broadly, financial globalization is expected to lead to a convergence of capitalisms, as capital owners will not accept differences in rates of return between countries when allocating their funds (Lorenzi, 2008).

Whether or not such a convergence of capitalisms or a level playing-field among welfare states actually occur will depend on the interplay between two factors. On the one hand, further policy convergence allows financial investors to exploit economies of scale and to maximise their profit share. On the other hand, different welfare state and policy configurations have been shown to be related to distinct comparative advantages in the tradable sector, producing similar aggregate productivity and employment growth rates (Ernst, 2004). In particular, Northern European countries have weathered their integration into global capital markets remarkably well. Whether or not a country is coming under pressure to reform its welfare state policies towards less redistribution, therefore, depends to a large extent whether policy complementarities within the existing framework can be built up such as to guarantee sufficiently high rates of returns for international investors.

E. Corporate governance and executive pay

An important microeconomic aspect of financial liberalization concerns the expected positive impact of a deeper, more competitive market for corporate control over executive performance and the quality of corporate governance. A key issue, in this regard, is the extent to which the level and growth of executive compensation corresponds to corporate performance. The following section reviews the empirical evidence regarding the link between a firm's performance and executive pay and discusses country specificities.

Does executive pay respond to performance?

The question of whether executive compensation reflects economic performance is very controversial; the results partly depend on the geographical focus of a given study. Research originally concentrated on the United States, where the bulk of studies reported a positive relation between pay and performance (Jensen and Murphy, 1990; Joskow and Rose, 1994; Kaplan, 1994; Boschen and Smith, 1995; Hallock, 1998; Hall and Liebman, 1998). Yet the validity of the findings has been questioned. A number of studies have found a statistically significant link, which is, however, financially unattractive and therefore fails to provide a strong incentive for executives (Jensen and Murphy, 1990; Garen, 1994). Other studies have found an even stronger link between compensation and performance (Hall and Liebman, 1998, Boschen and Smith, 1995). Several papers providing a meta-analysis of existing research (Tosi et al., 2000; Dalton et al, 2003) suggest that no widespread, strong link between compensation and performance has been established so far.

The pay-performance relation has also been examined in companies outside the United States. A statistically significant pay-performance relation has been reported with regard to Canada (Zhou, 1999). The findings of research focusing on Asia are more complex. Kato and Long (2005) document a positive relation between pay and performance among Chinese companies. According to Firth et al. (2006), however, the pay-performance link is weak, which – in their view – raises questions about the effectiveness of firms' incentive systems. Kato and Kubo (2006), Kato et al. (2006) and Unite et al. (2008)

also identify a positive relationship with regard to Japanese, Korean, and Philippine firms, respectively. Evidence from European countries presents a mixed picture. A number of studies relating to the United Kingdom find a low pay-performance sensitivity (Gregg et al., 2005; Conyon and Murphy, 2000; Ozkan, 2007). Bruce et al. (2007) come to the same conclusion with regard to bonuses within UK companies. For Germany, Haid and Yurtoglu (2006) report a weak relation between compensation and performance, whereas Conyon and Schwalbach (2000) find that the relation is positive in both Germany and the United Kingdom. By contrast, recent studies on Portugal (Fernandes, 2008) and the Netherlands (Duffhues et al., 2007) do not find any such relation. In Australia, the findings vary. While Defina et al. (1994) do not find a significant connection between pay and performance, Matolcsy (2000) reports that such a connection exists at times of economic growth but not during an economic slowdown. Recently, Merhebi et al. (2006) have documented a statistically significant link between pay and performance but concede that its economic relevance is rather low.

Overall, a stable and significant relation between pay and performance has yet to be established; where such exists, it may be expected to be country-specific, depending largely on a country's economic, institutional and cultural peculiarities. Moreover, various studies focusing on Asian countries emphasize that a positive pay-performance relation holds only for a certain type of firms. No such relation could be identified in Chinese state-owned companies (Firth et al., 2006, Kato and Long, 2005), in Korean non-chaebol companies (Kato et al., 2006) or in companies with an affiliation to a family group (Unite et al., 2008). In Japanese companies, Abe et al. (2005) find that compensation is less sensitive to performance in firms with a main bank relationship or a bank-appointed member of the board of directors.

Diversity of corporate governance models and executive pay

Three factors have been found to shape the evolution of executive pay: (a) the role of directors; (b) the role of institutional investors and employee representatives; and (c) the role of consultancy firms.

A number of studies, in particular those using the managerial power approach, have devoted considerable attention to the link between compensation and performance and to the presence (or absence) of institutional factors restricting (or increasing) executives' managerial discretion. Among other things, these studies highlight the role of the composition of the board of directors. Evidence relating to US and Portuguese firms suggests that compensation is higher when the board is larger, since this renders organized opposition by directors against executives more difficult (see Core et al, 1999, Fernandes, 2008). This finding has recently been confirmed in a cross-national study by Otten and Heugens (2007) of executive salaries and bonuses in 17 countries. Similarly, compensation is higher if the appointment of the majority of the executives has been influenced by the CEO. The CEO's relationship with the other executives and with the bodies in charge of determining executive compensation also seems to be a relevant factor. As far as the United States is concerned, it has been argued that directors' and executives' interests are closely intertwined, as directors have an interest in being reappointed to the board (for financial and social reasons). Since the slate containing the list of candidates to be nominated in the management is normally the only slate for elections, CEOs in the United States have significant influence over re-appointment. Directors therefore have an interest in maintaining a good relationship with the CEO. This may, however, affect their capacity to supervise decisions on the compensation of executives (Bebchuk and Fried, 2003). Evidence confirming this assumption is provided by Core et al. (1999), who show that CEO compensation is higher when directors have been appointed by the CEO directly.

Secondly, the presence of institutional investors has been identified as having an influence on executive compensation. A study by Hartzell and Starks (2002) covering a large number of firms in the United States between 1991 and 1997 finds that the higher the number of institutional investors, the lower the compensation of executives, and vice versa. David, Kochar and Levitas (1998) distinguish between institutional investors that have other business relationships with the firm and those that have not. They find that the level of executive compensation is positively related with the former and negatively with the latter. Comparable findings are reported in the case of the United Kingdom, where, in their study of a large number of companies, Dong and Ozkan (2007) document that, while the mere presence of institutional investors neither constrains the level of executive pay nor strengthens the pay-performance relationship, “dedicated investors with long-term horizons” do have a positive influence on both factors.

A final factor in the shaping of executive compensation is the role played by compensation consulting firms providing companies with data and advice regarding compensation. Bebchuk and Fried (2003) argue, with regard to the United States, that since it is typically the human resources departments of companies that select such consultancy firms (which are in turn accountable to the executive board) a conflict of interest may arise: consultants have an interest not only in providing the best advice regarding executive compensation but also in being rehired by the company (or hired by other companies). Crystal (1991) has also documented that consultants who provide CEO compensation advice frequently conduct work in the same firms in other areas. This may create an incentive for the consultants to avoid giving advice that may be regarded as inconvenient by the executive board, in order not to lose additional contract opportunities (*ibid.*). Other studies show that consultancy firms may propose an increase in executive compensation even when the company performance is below par. According to Gillan (2001), they usually propose compensation packages that are either performance-driven or peer group-driven, that is, based on a comparison with compensation packages in other firms. They can thus shift from one method of calculation to another, depending on the circumstances, but not necessarily on the basis of corporate performance. Moreover, a memorandum of the House of Representatives of the United States, dated 6 March 2008, provides evidence of a case where, after one consultancy firm had recommended a reduction in CEO pay, the management of the company had hired another which was more compliant with the CEO's interests (House of Representatives, 2008).

Policy developments

In many countries, proposals have been put forward with a view to mitigating the problems of executive compensation illustrated above. Understandably, given the wide variations that exist, proposals are highly country-specific.

A number of the proposals deal with the institutional framework in which executive compensation is determined. In the United States, some urge that the share holder meeting, usually referred to as “say on pay”, should have an enhanced role, in the form of a non-binding vote on executive compensation. While not having a veto, shareholders would thus have an institutional platform at which to express their disagreement with a company's remuneration policy (Gopalan, 2007). Similarly, the Austrian trade unions recently proposed stronger information rights for shareholders on executive compensation (Arbeitsnehmerkammer Wien, 2008). Another proposal is to strengthen the committee in charge of determining compensation. For instance, German trade unions suggest that supervisory boards in that country should have more power and, in particular, that employee representatives should be involved more closely in determining compensation (German Trade Union Federation, 2008).

Secondly, there are also proposals relating to the criteria used to set executive compensation. German and Austrian trade unions have proposed that not only personal performance and firm performance but also social and environmental sustainability should be taken into account (*ibid.*; Arbeitnehmerkammer Wien, 2008).

A third group of proposals – in the United States, Austria and elsewhere (Anderson et al., 2007 and Arbeitnehmerkammer Wien, 2008) – calls for more rigid taxation, the suggestion being that companies should no longer be able to deduct executive compensation as a business expense. This would discourage excessively high executive compensation by increasing the costs to the company.

F. Policy considerations

Financial globalization has not lived up to its promises. True, financial globalization can contribute to improve the allocation of savings and investment and thus support growth and incomes –this is why it would be wrong to close the economy to international capital flows. However, the chapter has argued that benefits have been slow to emerge even in countries that opened up more quickly and have often been reversed by financial crises that wiped out earlier income and employment gains. Moreover, financial globalization seems to have eroded bargaining power of employees, contributing to the trend decline in the wage share over and above any effect resulting for instance from trade integration or sectoral change. Financial globalization under insufficiently developed domestic banking markets will increase the risk of financial crises.

The main policy implication from these findings is that governments should take into account the social impacts of financial globalization before engaging in an all-embracing opening of capital markets. A cautious approach to financial globalization is especially important in countries where financial markets are not sufficiently developed and where supervision mechanisms are weak. But in all countries, it is crucial to reinforce prudential regulation so as to reduce irresponsible risk-taking on the part of certain financial actors. Indeed there is a “moral hazard” problem in that these actors grasp all the gains from irresponsible financial positions, while the losses from such operations are partly shifted to society. However, foreign direct investment should be allowed to enter, especially in the case of emerging economies and developing countries, which can benefit the most from such investments in terms of technological transfer and productivity growth.

There is also a role for coordinated action among countries. As the recent sub-prime crisis has demonstrated, financial turbulence in one country (especially if it is a large one) tends to spill over to other countries. Several policy options have been put forward in this respect, such as a more wide-spread use of regional currency areas with “seigniorage” sharing agreements. Though the merits and de-merits of each proposed solution could not be analyzed in this chapter, it is interesting to note that most of the proposals involve some form of regulation of financial practices.

Appendix A

The impact of financial market crises on growth and inequality: An empirical assessment

The purpose of this Appendix is to present baseline evidence of the link between financial crisis and growth and financial crisis and inequality. This is done by means of panel regressions estimated by FGLS using five eight-year non-overlapping windows for the period 1960-2006. The sample used in the regressions consists of 146 countries in the analysis of economic growth and 102 countries in the case of inequality. The difference in the number of countries taken into account by both regressions is explained by the difficulty in finding information on inequality for all countries for the period studied.

The methodology employed is similar to that presented in Ranci re et al. (2008), but adding an equation to test for the effect of banking crisis on inequality. The following equations have been estimated:

$$(1) \Delta Y_{it} = \gamma X_{it} + \beta_1 \mu_{\Delta B, it} + \beta_2 \sigma_{\Delta B, it} + \beta_3 sk_{\Delta B, it} + \varepsilon_{it}$$

$$(2) G_{it} = \gamma X_{it} + \beta_1 \mu_{\Delta B, it} + \beta_2 \sigma_{\Delta B, it} + \beta_3 sk_{\Delta B, it} + \varepsilon_{it}$$

Growth (ΔY_{it}) is measured by the average growth rate of per-capita GDP and inequality (G_{it}) by the Gini coefficient (expressed in logs). Regarding the explanatory variables, the three moments of credit growth: the mean ($\mu_{\Delta B, it}$), the standard deviation ($\sigma_{\Delta B, it}$), and the skewness ($sk_{\Delta B, it}$), are used as a measure of financial development and financial crisis. The

Table 2.A1. Definitions and sources of variables used in the regression analysis

Variable	Definition	Source
GDP per capita growth	Annual growth rate.	World Development Indicators (2007).
Gini coefficients		World Development Indicators (2007).
Initial GDP per capita	Initial value of ratio of total GDP to total population (in logs). GDP is in 2000 constant US\$.	World Development Indicators (2007).
Initial secondary schooling	Ratio of total secondary enrolment, regardless of age, to the population of the age group that officially corresponds to that level of education. Expressed in logs.	World Development Indicators (2007).
CPI Consumer price index	Consumer price index (2000 = 100) at the end of the year.	IFS data – line 64 ZF and 64 XZF.
Real credit growth	Annual growth rate of real domestic bank credit claims on the private sector.	Institute calculations based on data from IFS – line 22: Claims on Private Sector. Domestic bank credit claims are deflated with end of the year CPI index.
Government consumption	General government final consumption expenditure as a % of GDP. Expressed in logs.	World Development Indicators (2007).
Inflation rate	Annual % change in CPI.	World Development Indicators (2007).
Trade openness	Trade (Exports + Imports) as a % of GDP.	World Development Indicators (2007).

Table 2.A2. Regression results

	Baseline regression		Reduced sample		Weighted regression		Outlier control	
	GDP per capita growth	Gini (log)	GDP per capita growth	Gini (log)	GDP per capita growth	Gini (log)	GDP per capita growth	Gini (log)
Bank credit growth	0.079 (26.40)**	1.2E-03 (27.55)**	0.079 (26.40)**	1.2E-03 (27.55)**	0.026 (9.25)**	6.9E-04 (12.37)**	0.123 (50.80)**	7.5E-04 (7.33)**
Bank credit variance	-0.021 (-20.74)**	-1.2E-03 (-41.00)**	-0.021 (-20.74)**	-1.2E-03 (-41.00)**	0.005 (2.13)*	-3.0E-04 (-4.24)**	-0.035 (-36.95)**	-1.6E-03 (-20.16)**
Bank credit skewness	-0.183 (-5.35)**	-4.4E-03 (-2.64)**	-0.183 (-5.35)**	-4.4E-03 (-2.64)**	-0.134 (-3.28)**	-2.2E-02 (-10.41)**	-0.244 (-7.90)**	-4.6E-03 (-2.63)**
Initial level of GDP per capita	-0.662 (-10.94)**	3.3E-02 (14.70)**	-0.662 (-10.94)**	3.3E-02 (14.70)**	-1.53 (-16.83)**	-4.7E-03 (-2.18)*	-0.447 (-8.59)**	2.9E-02 (9.22)**
Initial level of secondary schooling	0.032 (13.27)**		3.2E-02 (13.27)**		2.9E-02 (8.85)**		2.7E-02 (18.15)**	
Inflation rate	-0.003 (-32.98)**	1.6E-05 (3.79)**	-0.003 (-32.98)**	1.6E-05 (3.79)**	-0.004 (-10.46)**	-5.4E-05 (-11.06)**	-0.002 (-13.85)**	7.7E-06 (1.12)
Government consumption	-1.39 (-13.63)**	-0.032 (-8.09)**	-1.39 (-13.63)**	-0.0322 (-8.09)**	-1.102 (-7.34)**	-0.190 (-32.46)**	-0.799 (-11.18)**	-2.1E-02 (-3.02)**
Trade openness	0.018 (14.30)**	-1.2E-04 (-3.70)**	0.018 (14.30)**	-1.2E-04 (-3.70)**	0.013 (10.64)**	-1.0E-03 (-32.94)**	0.011 (12.75)**	8.1E-05 (2.24)*
Constant	6.33 (13.72)**	3.46 (408.28)**	5.88 (13.10)**	3.39 (212.42)**	13.42 (19.92)**	4.08 (209.57)**	4.81 (13.16)**	3.33 (92.33)**
Observations	559	236	559	236	559	236	509	223
Number of countries	146	102	146	102	146	102	135	96

Note: Estimated based on feasible generalized least squares. All regressions are controlled for regional-fixed effects. Absolute value of z statistics in parentheses. The error terms are corrected for heteroskedasticity and autocorrelation. Significance levels: * significant at 5%; ** significant at 1%.

Source: ILS estimates

variable used for this purpose is the growth rate of real bank credit to the private sector. Finally, X_{it} is a vector of control variables and ε_{it} is the error term. In this analysis, the control set used includes initial per-capita GDP (in logs), the initial ratio of secondary schooling, the inflation rate, the ratio of government consumption as a percentage of GDP (in logs) and a measure of trade openness ($X+M / GDP$). An overview of the different variables used and their sources and definitions can be found in table 2.A1.

The moments of credit growth and the variables measured in averages are computed over each of the five different periods considered (1960-1969; 1970-1978; 1979-1987; 1988-1996, and; 1997-2006) and the initial variables are measured in the first year of each period. All panel regressions are estimated with fixed-effects and controlled for heteroskedasticity and auto-correlation of the error terms.

Robustness tests include the restriction of the country sample by excluding emerging Europe and Central Asian countries due to their more limited coverage over time. Moreover, the estimates have also been run by weighting observations with GDP per capita levels and by excluding outliers to ensure that no particular data point is driving the regression. Outlier detection has been based on the Cook statistics. Table 2.A2 summarizes the different equations and robustness checks.

Appendix B

Empirical studies regarding pay for performance

Author and country	Reference	Findings on the link between executive compensation and firm performance	Method used
Dardour, A. (2008) France	Forthcoming.	Finds a positive but weak and insignificant link between executive compensation and firm performance.	Examines 250 companies for the period of 2002-2005. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based and accounting-based performance measures.
Fernandes, N. (2008) Portugal	Board compensation and firm performance: the role of "independent" board members, <i>Journal of Multinational Financial Management</i> 78, 30-44.	Does not find a link between executive compensation and firm performance and documents that not even the variable component is related to firm performance.	Examines 58 companies for the period of 2002-2004. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based performance measures.
Ozkan, N. (2008) United Kingdom	CEO Compensation and Firm Performance: An Empirical Investigation of UK Panel Data, available at SSRN: http://ssrn.com/abstract=1102703 .	Finds a weak positive link between executive compensation and firm performance.	Examines 390 companies for the period of 1999-2005. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based performance measures.
Unite, A.A., Sullivan M.J., Brookmann, J., Majadillas, M.A., and Taningco, A. (2008) Philippines	Executive pay and firm performance in the Philippines, <i>Pacific-Basin Finance Journal</i> forthcoming. Available in the final version as accepted by the journal under: https://science-direct.com .	Finds a positive link between executive compensation and firm performance. This holds, however, only for companies that are not affiliated to a corporate group.	Examines 125 companies for the period of 2001-2002 and 148 firms for the period of 2002-2003. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Duffhues, P. and Kabir, R. (2007) Netherlands	Is pay-performance relationship always positive? Evidence from the Netherlands, <i>Journal of Multinational Financial Management</i> 18, 45-60.	Does not find a link between executive compensation and firm performance.	Examines 135 companies for the period of 1998-2001. Analyzes fixed and variable cash compensation, but also includes a smaller sample of companies in order to analyze share-based compensation. Takes into account stock market based and accounting-based performance measures.
Firth, M., Fung, P., Rui, O. (2006) China (mainland)	Corporate performance and CEO compensation in China, <i>Journal of Corporate Finance</i> 12, 693-714.	Finds a positive but weak link between executive compensation and firm performance, and only for firms whose major shareholder is not a state agency.	Examines 549 companies for the period of 1998-2000. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Haid, A., Yurtoglu, B. (2006) Germany	The impact of ownership structure on executive compensation in Germany, <i>Journal of Multinational Financial Management</i> , forthcoming.	Finds a "negligibly" weak link between executive compensation and firm performance.	Examines 160 companies for the period of 1987-2001. Analyzes fixed and variable cash compensation. Takes into account stock market based performance measures.
Kato, T., Kim, W. and Lee, J.H. (2006) South Korea	Executive compensation, firm performance and chaebols in Korea: evidence from new panel data, <i>Pacific-Basin Finance Journal</i> 15, 36-55.	Finds a positive link between executive compensation and firm performance. This does, however, not apply to chaebol firms.	Examines 246 companies for the period of 1998-2001. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.

Author and country	Reference	Findings on the link between executive compensation and firm performance	Method used
Kato, T., Kubo, K. (2006) Japan	CEO compensation and firm performance in Japan: evidence from new panel data on individual CEO pay, <i>Journal of Japanese and International Economies</i> 20, 1–19.	Finds a positive link between executive compensation and firm performance.	Examines 51 companies for the period of 1986-1995. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Merhebi, R, Pattenden, K., Swan, P.L. and Xianming, Z. (2006) Australia	Australian chief executive remuneration: pay and performance, <i>Accounting and Finance</i> 46, 481-487.	Finds a positive link between executive compensation and firm performance, admitting that the link is statistically but not economically relevant.	Examines 722 companies for the period of 1990-1999. Analyzes fixed and variable cash compensation. Takes into account stock market based performance measures.
Abe, N., Gaston, N. and Kubo, K. (2005) Japan	Executive pay in Japan: the role of bank-appointed monitors and the main bank relationship, <i>Japan and the World Economy</i> 17, 371–394.	Finds a positive link between executive compensation and firm performance. The pay-performance relation in Japan is weaker for companies with a Main Bank link or a bank-appointed member of the board of directors, but executive compensation in those companies is also lower.	Examines 55 companies for the period of 1989-1999. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Paul Gregg, P., Jewell, S., Tonks, I. (2005) UK	Executive Pay and Performance in the UK 1994-2002, CMPO Working Paper Series No. 05/122.	Find a weak positive link between executive compensation and firm performance. Also identify an asymmetric link between pay and performance: In years and for companies in which stock returns are relatively high, pay-performance elasticities are high, but executive pay is less sensitive to performance in those cases when stock returns are low.	Examines 415 companies for the period of 1994-2002. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Kato, T. and Long, C. (2005) China (mainland)	Executive compensation, firm performance, and corporate governance in China: evidence from firms listed in the Shanghai and Shenzhen stock exchanges, <i>Economic Development and Cultural Change</i> 54, 945-983.	Finds a positive link between executive compensation and firm performance. Chinese executives are penalized for making negative profits although they are neither penalized for declining profits nor rewarded for rising profits insofar as it is positive. The pay-performance link is weaker with regard to companies whose major share-holder is a state agency.	Examines 942 companies for the period of 1998-2002. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Dalton, D.R., Daily, C.M., Certo, S.T. and Roengpitya, R. (2003).	Meta-analysis of Financial Performance and Equity: Fusion or Confusion? <i>Academy of Management Journal</i> 46, 13-26.	Reports that only a few studies find a systematic link between executive compensation and firm performance.	Provides a meta-analysis of 229 empirical studies on the link between executive compensation and firm performance.
Conyon, M., Murphy, K. (2000) UK	The prince and the pauper? CEO pay in the United States and United Kingdom, <i>Economic Journal</i> 110, 640–671.	Documents a stonger pay-performance link for the US than for the UK.	Examines 510 companies for 1997. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based performance measures.
Conyon and Schwalbach (2000) UK Germany	Conyon, M.J. and Schwalbach, J.. (2000). Executive Compensation: Evidence from the UK and Germany, <i>Long Range Planning</i> 33, 504-526.	Finds a positive link between executive compensation and firm performance in both countries.	Examines 102 companies for the period of 1969-1995 (UK) as well as 48 companies for the period of 1968-1994 (Germany). Analyzes fixed and variable cash compensation. Takes into account stock market based performance measures.

Author and country	Reference	Findings on the link between executive compensation and firm performance	Method used
Matolcsy, Z.P. 2000 Australia	Executive cash compensation and corporate performance during different economic cycles, <i>Contemporary Accounting Research</i> , 17, 671-688, also available at SSRN: http://ssrn.com/abstract=167068 .	Finds a positive link between executive compensation and firm performance during periods of economic growth but no link during periods of economic downturn.	Examines 100 companies for the period of 1988-1995. Analyzes fixed and variable cash compensation. Takes into account accounting-based performance measures.
Zhou, X. (2000) Canada	CEO pay, firm size, and corporate performance: evidence from Canada, <i>Canadian Journal of Economics</i> 33, 213-252.	Finds a positive link between executive compensation and firm performance.	Examines 755 companies for the period of 1991-1995. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based performance measures.
Hall, B., Liebman, J. (1998) USA	Are CEOs really paid like bureaucrats?, <i>Quarterly Journal of Economics</i> 113, 653-691.	Finds a strong positive link between executive compensation and firm performance, pay-performance sensitivity increased over the period studied.	Examines 426 companies for the period of 1980-1994. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based and accounting-based performance measures.
Tosi, H.L., Werner, S., Katz, J.P. & Gomez-Mejia, L.R. (2000). USA	How much does performance matter? A meta-analysis of CEO pay studies. <i>Journal of Management</i> , 26, 301-339.	Reports that the empirical research has only documented a weak link between executive compensation and firm performance.	Provides a meta-analysis of 137 empirical studies on the link between executive compensation and firm performance.
Boschen, J.F. and K.J. Smith (1995) USA	You can pay me now and you can pay me later: the dynamic response of executive compensation to firm performance, <i>Journal of Business</i> 68, 577-608.	Finds a positive link between executive compensation and firm performance, pay-performance sensitivity increased over the four decades studied.	Examines 16 companies for the period of 1948-1990. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based measures.
Defina, A, Harris, T.C., Ramsay, I.M. 1994 Australia	What is Reasonable Remuneration for Corporate Officers? An Empirical Investigation into the Relationship between Pay and Performance in the Largest Australian Companies <i>Company and Securities Law Journal</i> 12, 6, 341-356.	Does not find a significant link between executive compensation and firm performance.	Examines 89 companies for the period of 1989-1990. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based and accounting-based performance measures.
Garen, J.E., 1994, USA	Executive Compensation and Principal-Agent Theory, <i>Journal of Political Economy</i> , 102, 6, 1175-1199.	Finds a weak link between firm-performance and executive compensation.	Examines 415 companies for 1988. Analyzes fixed and variable cash compensation. Takes into account stock market based and accounting-based performance measures.
Joskow, P. and Rose, N. (1994) USA	CEO pay and firm insurance: dynamics, asymmetries, and alternative performance measures. NBER Working Paper No. 4976, National Bureau of Economic Research.	Finds a positive link between executive compensation and firm performance.	Examines 678 companies for the period of 1970-1990. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based and accounting-based performance measures.
Kaplan, S. (1994) USA Japan	Kaplan, S. (1994), Top executive rewards and firm performance: a comparison of Japan and the United States, <i>Journal of Political Economy</i> 102, 510-546.	Finds a positive link between executive compensation and firm performance.	Examines 119 Japanese companies and 146 US companies for 1980. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based and accounting-based performance measures.
Jensen, M. and Murphy, K. (1990) USA	Jensen, M. and Murphy, K.J. (1990), Performance pay and top-management incentives, <i>Journal of Political Economy</i> 98, 225-264.	Finds a statistically significant but weak positive link between executive compensation and firm performance.	Examines 73 Japanese for the period of 1969-1983. Analyzes fixed and variable cash compensation and share-based compensation. Takes into account stock market based performance measures.

References

- Abe, N.; Gaston, N.; Kubo, K. 2005. "Executive pay in Japan: The role of bank-appointed monitors and the main bank relationship", in *Japan and the World Economy*, Vol. 17, No. 3, pp. 371-394.
- Acemoglu, D.; Zilibotti, F. 1997. "Was Prometheus unbound by chance? Risk, diversification, and growth", in *Journal of Monetary Economics*, Vol. 50, No. 1, pp. 709-751.
- Anand, S.; Segal, P. 2008. "What do we know about global income inequality", in *Journal of Economic Literature*, Vol. 46, No. 1, pp. 57-94.
- Anderson, S. et al. 2007. *Executive excess 2007. The staggering social cost of U.S. business leadership*, (Washington D.C., US, Institute for Policy Studies and United for a fair Economy). Available at: <http://www.ips-dc.org/reports/070829-executiveexcess.pdf>
- Arbeitnehmer-Kammer Wien. 2008. *Trotz Börsenkrise erneut Rekordgagen für ATX-Manager*. Available at: <http://www.arbeiterkammer.at/www-192-IP-41005.html>
- Bebchuk, L.A.; Fried, J.A. 2003. "Executive compensation as an agency problem", in *Journal of Economic Perspectives*, Vol. 17, No. 3, pp. 71-92.
- Beck, R.; Fidora, M. 2008. "The impact of sovereign wealth funds on global financial markets", *Occasional Paper Series No. 91* (Frankfurt am Main, European Central Bank).
- Bonfiglioli, A. 2007. *Financial integration, productivity and capital accumulation*, (Barcelona, Centre de Recerca en Economia Internacional), unpublished document.
- Boschen, J.F.; Smith, K.J. 1995. "You can pay me now and you can pay me later: the dynamic response of executive compensation to firm performance", in *Journal of Business*, Vol. 68, No. 4, pp. 577-608.
- Bruce, A. et al. 2007. "Executive bonus and firm performance in the UK", in *Long Range Planning*, Vol. 40, No. 3, pp. 280-294.
- Chinn, M.; Ito, H. 2007. "A new measure of financial openness", unpublished document.
- Choi, M. 2001. "Threat effect of foreign direct investment on labor union wage premium", Working Paper No. 27 (Amherst, MA, Political Economy Research Institute).
- Canyon, M.J.; Murphy, K.J. 2000. "The prince and the pauper? CEO pay in the United States and United Kingdom", in *Economic Journal*, Vol. 110, No. 461, pp. 640-671.
- Canyon, M.J.; Schwalbach, J. 2000. "Executive compensation: Evidence from the UK and Germany", in *Long Range Planning*, Vol. 33, No. 4, pp. 504-526.
- Core, J.E.; Holthausen, R.W.; Larcker, D.F. 1999. "Corporate governance, chief executive officer compensation, and firm performance", in *Journal of Financial Economics*, Vol. 51, No. 3, pp. 371-406.
- Crystal, G. S. 1991. *In search of excess*. (New York, NY Norton)
- Dalton, D.R. et al. 2003. "Meta-analyses of financial performance and equity: fusion or confusion?", in *Academy of Management Journal*, Vol. 46, No. 1, pp. 13-26.
- Dardour, A. 2008, "Les déterminants de la rémunération du premier dirigeant des sociétés cotées en France Etude empirique sur les sociétés de l'indice SBF 250", forthcoming.
- David, P.; Kochhar, R.; Levitas, E. 1998, "The effect of institutional investors on the level and mix of CEO compensation", in *Academy of Management Journal*, Vol. 41, pp. 200-208.
- Davies, J.B.; Sandström, S.; Shorrocks, A.; Wolff, E. N. 2008. *The world distribution of household wealth*, Discussion Paper No. 2008/03 (Helsinki, UNU-WIDER).
- Defina, A.; Harris, T.; Ramsay, I. 1994. "What is reasonable remuneration for corporate officers? An empirical investigation into the relationship between pay and performance in the largest Australian companies", in *Company and Securities Law Journal*, Vol. 12, No. 6, pp. 341-356.
- Demirgüç-Kunt, A.; Kane, E.; Laeven, L. 2006. "Deposit insurance design and implementation: Policy lessons from research and practice", World Bank Policy Research Working Paper 3969.
- Deutscher Gewerkschaftsbund (German Trade Union Confederation), Bundesvorstand. 2008. DGB Vorschläge für ein gesetzliches Maßnahmenbündel zur Regulierung der Vorstandsvergütung, http://www.dgb.de/themen/mitbestimmung/untern_mitbest/weiterentwicklung.htm
- Diwan, I. 2001. "Debt as sweat: Labor, financial crises, and the globalization of capital", unpublished manuscript

- Dong, M.; Ozkan, A. 2007. "Institutional investors and director pay. An empirical study of UK companies", in *Journal of Multinational Financial Management*, Vol. 18, pp. 16-29.
- Duffhues, P.; Kabir, R. 2007. "Is pay-performance relationship always positive? Evidence from the Netherlands", in *Journal of Multinational Financial Management*, Vol. 18, pp. 45-60.
- Duval, R.; Elmeskov, J.; Vogel, L. 2007. *Structural policies and economic resilience to shocks*, OECD Economics Department Working Paper No. 567 (Paris).
- Ernst, E. 2004. "Financial systems, industrial relations and industry specialization: An econometric analysis of institutional complementarities", in H. Schubert (ed.): *The Transformation of the European Financial System*, (Vienna, Austrian Central Bank), pp. 60-95.
- Ernst, E.; Amable, B.; Palombarini, S. 2005. "How do financial markets affect industrial relations: An institutional complementarity approach", in *Socio-Economic Review*, Vol. 3, No. 2, pp. 311-330.
- Ernst, E.; Escudero, V. Forthcoming. 2008. "Will the next globalization be great? Evidence on the effects of globalization on employment and inequality", Discussion Paper No. 191 (International Institute for Labour Studies, Geneva).
- Felton, F.; Reinhart, C. (eds.) 2008. *The first financial crisis of the 21st century* (London, Center for Economic Policy Research).
- Fernandes, N. 2008. "Executive compensation: Board compensation and firm performance: the role of "independent" board members", in *Journal of Multinational Financial Management*, Vol. 18, No. 1, pp. 30-44.
- Firth, M.; Fung, P.; Rui, O. 2006. "Corporate performance and CEO compensation in China", in *Journal of Corporate Finance*, Vol. 12, No. 4, pp. 693-714.
- Fisher, S. 2003. "Globalization and its challenges", in *American Economic Review*, Vol. 93, No. 2, pp. 1-30.
- Garen, J.E. 1994. "Executive compensation and principal-agent theory", in *Journal of Political Economy*, Vol. 102, No. 6, pp. 1175-1199.
- Gillan, S.L. 2001. "Has pay for performance gone awry? Views from a corporate governance forum", in *Research Dialogue*, Vol. 68, No. 1, pp. 1-16.
- Gopalan, S. 2007. "Say on pay, and the SEC disclosure rules: Expressive law and CEO compensation", in *Pepperdine Law Review*, Vol. 35, pp. 101-163.
- Gourinchas, P.-O.; Jeanne, O. 2007. *Capital flows to developing countries: The allocation puzzle*, National Bureau of Economic Research (NBER), Working Paper, No. 13602 (Cambridge, MA).
- Gregg, P.; Jewell, S.; Tonks, I. 2005. "Executive pay and performance in the UK 1994-2002", Center for Market and Public Organisation (CMPO) Working Paper Series No. 05/122 (University of Bristol). Available at: <http://www.bristol.ac.uk/cmipo/publications/papers/2005/wp122.pdf> [21 August 2008].
- Haid, A.; Yurtoglu, B. 2005 *The impact of ownership structure on executive compensation in Germany*, paper presented at the 32nd Conference of the European Association for Research in Industrial Economics (EARIE), September 2005. Available at: http://www.fep.up.pt/conferences/earie2005/cd_rom/Session%20VII/VII.A/burcin.pdf [20 August 2008].
- Hall, B.; Liebman, J. 1998. "Are CEOs really paid like bureaucrats?", in *Quarterly Journal of Economics*, Vol. 113, Aug., pp. 653-691.
- Hallock, K. F. (1997). "Reciprocally interlocking boards of directors and executive compensation", in *Journal of Financial & Quantitative Analysis*, Vol. 32, No. 3, pp. 331-344.
- Hartzell, J.C.; Starks, L.T. 2002. "Institutional investors and executive compensation", in *The Journal of Finance*, Vol. 58, No. 6, pp. 2351-2374.
- Henry, P. B. 2007. "Capital Account Liberalization: Theory, Evidence, and Speculation" in *Journal of Economic Literature*, Vol. 45, pp. 887-935.
- House of Representatives, Committee on Oversight and Government Reform. 2008. Institutional Shareholder Service (Australia). 2006. *CEO pay – It's even higher than you think. Valuation of executive options in Australia 2006* (Melbourne).
- Instituto Nacional de Estadística y Censos (INDEC). 2008. *Brecha de la pobreza en el total de aglomerados urbanos, desde mayo 2001 en adelante* [Poverty gaps in urban agglomerations from 2001 onwards] (Buenos Aires).
- International Monetary Fund (IMF). 2006. *Ecuador: Selected issues*, Country Report No. 06/103 (Washington, DC).

- . 2007. *World Economic Outlook: Globalisation and Inequality* (Washington, DC).
- Jaumotte, F.; Tytell, I. 2007. *How has the globalization of labor affected the labor income share in advanced countries?*, IMF Working Paper, no. 07/298 (Washington, DC).
- Jensen, M. and Murphy, K.J. 1990. "Performance pay and top-management incentives", in *Journal of Political Economy*, Vol. 98, pp. 225-264.
- Joskow, P.; Rose, N. 1994. *CEO pay and firm insurance: dynamics, asymmetries, and alternative performance measures*. National Bureau of Economic Research Working Paper No. 4976.
- Kalemlı-Özcan, S.; Sorensen, B. E.; Yosha, O. 2001. "Risk sharing and industrial specialization: Regional and international evidence", in *American Economic Review*, Vol. 93, No. 3, pp. 903-918.
- Kaplan, S. 1994. "Top executive rewards and firm performance: a comparison of Japan and the United States", in *Journal of Political Economy*, Vol. 102, pp. 510-546.
- Kato, T.; Kim, W.; Lee, J.H. 2006. "Executive compensation, firm performance and chaebols in Korea: evidence from new panel data", in *Pacific-Basin Finance Journal*, Vol. 15, No. 1, pp. 36-55.
- Kato, T.; Kubo, K. 2006. "CEO compensation and firm performance in Japan: evidence from new panel data on individual CEO pay", in *Journal of Japanese and International Economies*, Vol. 20, No. 1, pp. 1-19.
- Kato, T.; Long, C. 2005. "Executive compensation, firm performance, and corporate governance in China: Evidence from firms listed in the Shanghai and Shenzhen stock exchanges", in *Economic Development and Cultural Change*, Vol. 54, pp. 945-983.
- King, R. G.; Levine, R. 1993. "Finance and growth: Schumpeter might be right", in *Quarterly Journal of Economics*, Vol. 108, No. 3, pp. 717-738.
- Kose, M. A. et al. 2006. *Financial globalization: A reappraisal*, IMF Working Paper No. 06/189 (Washington, DC).
- Kose, M. A.; Prasad, E. S.; Terrones, M. E. 2008. "Does openness to international financial flows contribute to productivity growth?", *IZA Discussion Paper*, no. 3634.
- Lane, P.; Milesi-Feretti, G. M. 2006. *The external wealth of nations mark II: revised and extended estimates of foreign assets and liabilities, 1970-2004*, IMF Working Paper No. 06/69 (Washington, DC).
- Laeven, L.; Valencia, F. 2008. "Systemic Banking Crises: A New Database", IMF Working Paper, No. 08/224 (Washington, DC).
- Lorenzi, J.-H. (ed.) 2008. *La guerre des capitalismes aura lieu*. [The war of capitalisms will take place] (Paris, Editions Perrin).
- Lucas, R. E. 1990. "Why doesn't capital flow from rich to poor countries?", in *American Economic Review*, Vol. 80, No. 2, pp. 92-96.
- Mahler, V. A.; Jesuit, D. K. 2006. "Fiscal Redistribution in the Developed Countries: New Insights from the Luxembourg Income Study," in *Socio-Economic Review*, Vol. 4, No. 3, pp. 483-511.
- Matolcsy, Z.P. 2000. "Executive cash compensation and corporate performance during different economic cycles", in *Contemporary Accounting Research*, Vol. 17, pp. 671-688.
- McKinnon, R. I. 1973. *Money and Capital in Economic Development* (Washington, DC, Brookings Institution).
- Mendoza, E. G.; Quadrini, V.; Rios-Rull, J.-V. 2007. *Financial integration, financial deepness and global imbalances*, National Bureau of Economic Research (NBER), Working Paper, No. 12909.
- Merhebi, R. et al. 2006. "Australian chief executive remuneration: Pay and performance", in *Accounting and Finance*, Vol. 46, No. 3, pp. 481-487.
- Mitchell, O. S.; Piggott, J.; Kumru, C. 2008. *Managing public investment funds: Best practices and new challenges*. National Bureau of Economic Research (NBER), Working Paper, No. 14078 (Cambridge, MA).
- Nellor, D. C. L. 2008. "The Rise of Africa's 'Frontier' Markets", in *Finance and Development*, Vol. 45/3.
- Obstfeld, M. 1998. "The global capital market: Benefactor or menace?", in *Journal of Economic Perspectives*, Vol. 12, No. 4, pp. 9-30.
- Obstfeld, M. 2007. *International finance and growth in developing countries: What have we learned?*, Draft prepared for the Commission on Growth and Development.

- Organisation for Economic Cooperation and Development (OECD). 2008a. *Economic Outlook no. 83* (Paris, June).
- . 2008b. *Economic Assessment of Indonesia* (Paris).
- . 2008c. *Latin American Outlook* (Paris).
- Otten, J. and Heugens, P. P.M.A.R. 2007. *Extending the managerial power theory of executive pay: A cross national test*, ERIM Report Series Reference No. ERS-2007-090-ORG. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1088215
- Ozkan, N. 2007. *CEO compensation and firm performance: An empirical investigation of UK panel data*, Working Paper. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102703
- Pagano, M.; Volpin, P. F. 2005. "Managers, Workers, and Corporate Control", in *Journal of Finance*, vol. 60/2, pp. 841-868.
- Prasad, E. S.; Rajan, R. G.; Subramanian, A. 2007. "Foreign capital and economic growth", in *Brookings Papers on Economic Activity*, Vol. 2007:1, pp. 153-209.
- Rancière, R.; Tornell, A.; Westermann, F. 2008. "Systemic Crises and Growth", in *Quarterly Journal of Economics*, Vol. 123/1, pp. 359-406.
- Reinhart, C.; Rogoff, K. 2008. "Is the 2007 US sub-prime financial crisis so different? An international historical comparison", in *American Economic Review*, Vol. 98, No. 3, pp. 339-344.
- Rodrik, D.; Subramanian, A. 2008. *Why did financial globalization disappoint?* (Cambridge, MA, Harvard University) unpublished document.
- Shaw, E. S. 1973. *Financial Deepening in Economic Development* (New York, Oxford University Press).
- Summers, L. H. 2000. "International financial crises: Causes, prevention, and cures", in *American Economic Review*, Vol. 90, No. 2, pp. 1-16.
- Supplemental Information on CEO Pay and the Mortgage Crisis*. Memorandum of 6 March 2008.
- The Economist Intelligence Unit (EIU). 2006. *Country Profile 2006: Argentina*, (London).
- Tosi, H.L. et al. 2000. "How much does performance matter? A meta-analysis of CEO pay studies." in *Journal of Management*, Vol. 26, pp. 301-339.
- Unite, A.A. Forthcoming. "Executive pay and firm performance in the Philippines", in *Pacific-Basin Finance Journal*. Preliminary version available at: http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6VFF-4R53W77-1&_user=1991186&_rdoc=1&_fmt=&_orig=search&_sort=d&view=c&_version=1&_urlVersion=0&_userid=1991186&md5=30ccbb457c8e0bec0b284df8fbedd02b [13 October 2008].
- World Bank. 2008. *World Development Indicators Online (WDI)*. Available at: <http://go.worldbank.org/U0FSM7AQ40> [7 October, 2008].
- Zhou, X. 2000. "CEO pay, firm size, and corporate performance: evidence from Canada", in *Canadian Journal of Economics*, Vol. 33, No. 1, pp. 213-252.