What are the potential alliances between countries and Finance?

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Until the financial crisis of 2007-2008, people were still singing the praises of financial globalisation, the liberalisation of capital movements and the fading of national borders in the face of finance. Today, it is disappointment that prevails. How can a balance be struck in lieu of such pendulum swings?

Financial globalisation does not always yield the efficiency gains expected of it. In an evocatively-entitled 2016 summary document, the FMI even asked the question: "Neoliberalism: Oversold?". According to the FMI, the profound market liberalisation movement underway since the early 1980s has can be said to have enabled certain advances. The expansion of global trade has made it possible, for instance, for millions of emerging country citizens to exit poverty, while foreign direct investment has served as a powerful lever for technology transfer in certain countries. Financial market liberalisation, in contrast, meaning the removal of national barriers in the face of capital movements, has not brought about the gains initially expected by economic theorists.

The benefits in terms of growth are marginal and financial integration has in fact led to poor resource allocation, especially in Europe in the 2000s, according to a recent study by Harvard economist, Githa Gopinath. Still more problematically, financial integration has sharply increased the likelihood of economic crisis, all the more so when bank regulation and surveillance is lacking, as Spain and Ireland learned in the 2000s, at their dramatic expense.

The costs of financial globalisation in terms of inequality, meanwhile, are exceedingly high. The IMF's recent study "Capital Account Liberalization and Inequality", which looked at 150 countries, shows that financial market liberalisation has significantly contributed to the rise in inequalities since the 1970s. According to theory, financial integration was supposed to enable better risk-sharing between wealthy countries and poor countries. In actuality, it triggered profound redistributive effects within countries, to the benefit of the wealthiest citizens, able to take advantage of the new globalised market, but at the expense of the poor citizens, without access to the credit market.

All in all, the bottom-line on financial integration as a catalyst for efficiency and equity is a very mixed picture, in any case, far more so than that of commercial integration. The two are interconnected, however. Financial integration calls commercial integration into question. While the latter also heightens inequalities, greater re-distribution could offer a response, providing compensation to those on the losing end. Financial globalisation, however, makes capital more mobile and thus redistribution more difficult, such that trade globalisation becomes politically unacceptable.

What can States do in this setting? And what is the right level of financial regulation? At the country level, or across groups of countries, e.g., the European Union? What lessons can we take away from these experiences, to develop the right regulation tools? Is the recently-born European Banking Union an example of a middle path that would make it possible to reconcile finance and countries?