Changes in International Financial Markets and Its Implications for the Developing Countries

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Main findings of this thesis are :

There are seven main changes in International Financial Market during the 1990's period.

- The most striking change in IFMs is the explosion of finance in international transactions in terms of its volume during the decade of 80s and particularly in 90s. This period ushered in a new phase in the evolution of international financial markets.
- Second change is integration and deregulation of IFMs. The process of market integration is bringing the financial markets closer and linking them with each other strongly. This integration process is there between countries, market sections and different financial institutions through a rapid movement of financial instruments such as bonds, equities and derivatives.
- The third major change is the process of privatization in IFMs. In the last two decades the main source of fiancé in IFMs has transformed from official to private sector.
- Fourth major change in IFMs is the securitisation of this market. In 80s and 90s we saw a major shift in international financial intermediation – away from banking to security markets (portfolio or equity investment).
- The traditional distinction between different kinds of financial institutions i.e. commercial banks, investment banks, finance companies etc. have given way to the single term – Foreign Institutional Investors.
- Sixth change in IFMs incorporates the qualitative changes brought about by 'Information Technology' (IT) revolution.
- Seventh change is the emergence of 'Derivatives Market' in IFMs. There exists a wide range of derivatives in the market and various new types are emerging over the period of time.

The empirical study (Chapter 6) based on multiple regression analysis shows that some country – specific (internal) factors have a significant impact on the size and magnitude of Foreign Portfolio Equity Investment flows to LDCs. The regression results show that out of nine internal factors three factors have significant impact on the inflows of FPEI to

LDCs i.e. stock market capitalization (STK), current account deficit (CAD) and foreign direct investment (FDI). The degree of explanatory power of regression result is fairly good ($R2 = 0.6$) .

The implications of these changes for LDCs

The overall changes in IFMs generally have both types of implications for LDCs – positive as well as negative. The main positive impacts include the increased availability of finance for trade and investment in recipient countries, more efficient global allocation of financial resources, international diversification of risk and providing a competitive environment for domestic financial sector and forcing them to improve their working and efficiency. On the negative side, the changes in IFMs have posed several challenges for the developing countries. Most important of these challenges are – excessive money supply and the consequent pressure on prices leading to the problem of volatility. Volatility of these markets in turn, has an adverse impact on nominal and real exchange rates and widening current account deficit leading to the problem of overall balance of payments.

An important lesson of the study is that the last two decades of rapid changes in IFMs have various implications for the growth and development of LDCs. But for getting optimum results these countries must try to maximize the positive and minimize the negative implications of these changes. The challenge to policy makers is to identify clearly the positive and negative aspects of these changes and evolve such an effective mechanism which promotes the positive part and check the adverse impacts of these changes in international financial markets.