Does Globalization Promote Financial Integration in South Asian Economies? Unveiling the Role of Monetary and Fiscal Performance in Internationalization

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Abstract
Presently, monitoring and analysing financial integration has become a key function and requirement of the financial regulatory bodies and central banks of the countries. It has also been observed that financial integration is important to make the financial system streamlined and efficient which is eventually used to make monetary policies and to judge a country's financial performance. Financial integration also highlights disruption in the financial system of the country if it does not work properly. This study has examined the impact of globalization on financial integration in the case of South Asian countries from 1996 to 2020. The results show that level of political instability has a negative and insignificant impact on financial integration. The outcome shows that monetary performance, globalization, and economic misery have positive and significant impacts on financial integration. Fiscal performance has a negative and significant impact on financial integration. Based on the results, it suggested that South countries should make stable monetary and fiscal performance with a rise in globalization to raise financial integration. Moreover, political instability and economic misery should be discouraged for higher financial integration.

Keywords: globalization, financial integration, political instability, monetary performance, fiscal performance, economic misery
JEL Classification: F60, F36, F50, O23,

1. Introduction
After the emergence of the European Union, the idea of socioeconomic, political, and financial integration has got much importance. Simply, financial integration is the procedure through which financial markets among nations are connected. More comprehensively, financial integration removes the barriers related to portfolio investment based on equity and debt, foreign direct investment, bank credit flows, and inter-state payment systems (Eyraud et al., 2017). Recently, it has been observed that with the increased degree of doing international business, financial integration has been the most prominent area of research for many financial experts (Vo and Daly, 2007). Financial integration provides help to the economies in many ways globally and extended research and implementation. With rising financial integration, the financial markets of the world are interconnected. However, few researchers shed light to understand the process of international financial integration and international financial process which in return provide in-depth benefits to the overall economy of the countries (Shirani and Tayebi, 2009).

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Financial integration is the process through which financial markets between two or more countries are connected. Financial integration is playing a key role to remove barriers in capital flows between countries, which include direct investment (FDI), portfolio investment (equity and debt), inter-state payment systems, and bank credit flows between countries. With the loss of barriers to capital flows, the flow of capital in each country that is mutually integrated would become highly dynamic. In the macroeconomic context, the level of economic development, such as GDP per capita becomes an essential factor in explaining the tendency of domestic residents to be involved in asset trading between countries (Alotaibi and Mishra, 2014). However, the interference of risk factors such as inflation and high exchange rate volatility could limit investors to invest in the domestic market and disrupt international financial integration.

Financial integration in Europe began several decades ago, in 1957, with the Treaty of Rome, which already contained the basic principles for the creation of a single European market for financial services. The adoption of the common currency in 1999 was a major impetus for further financial integration in the European Union. With all the theoretical and empirical evidence, the issue of the Euro undoubtedly offered a strong motivation for the procedure because a single currency is an important component of a common financial system and a strong promoter of financial integration. Now, the world has become a global village, and the financial markets of the world are more integrated (Audi et al., 2022; Audi et al., 2021). Globalization is a process that describes how trade and advanced technology have made the world a more connected and interdependent place. Different studies (Vo and Daly, 2007) have highlighted different determinants of financial integration. There is hardly any study that examines the role of globalization on financial integration in the case of South Asian countries. Following empirical and theoretical literature (Mishkin, 2009; Chinn and Ito 2006; Fischer, 2001; Agénor, 2003), this study also links political instability, economic misery, fiscal performance, and monetary performance with financial integration among the South Asian countries.

2. Literature Review

The availability of physical capital in the process of production and growth is as necessary as blood for the human body (Ali, 2015), and the lack of physical capital disturbed the route to economic growth (Arora, 2001; Rodrik, 2005; Ali and Rehman, 2015). Developing countries e.g. South Asian countries are facing the issue of insufficient physical capital. The insufficiency of physical capital can be overcome by different types of injections i.e. foreign aid, foreign debt, issuance of currency notes without reserves, and financial integration. Among them, financial integration is the center of this study, the neoclassical theory of economic growth has approved that financial integration has a multiplier impact on economic growth (Solow, 1956; Romer, 1986; Mankiw et al., 1995), as capital flows from capital abundant countries to capital scare countries. Financial integration is the process through which financial markets among countries are interconnected, and the barriers related to portfolio investment based on equity and debt, foreign direct investment, bank credit flows, and inter-state payment systems are removed (Eyraud et al., 2017).

Being the main indicator of economic growth, a sufficient amount of capital is necessary for production. But developing countries have less amount of capital to achieve the required target of economic growth, for this purpose, developing countries rely on developed countries. It is financial integration that enables developing and developed countries to share capital, the best example of this concern is the European Union. Financial integration refers to the reduction of barriers to the movement of capital among countries. So, the scarcity of capital in developing countries can be overcome with the help of capital-abundant developed counties. Although the concept of globalization is not the new one, still it is a debatable issue among policymakers and researchers. Stiglitz (2002) points out that globalization brings mergers among countries of the world, as there is a huge reduction in transportation costs, low communication, trade, knowledge, services, and individual movement barriers. Hence, globalization promotes the integration of world economies, with the same technological processes, cultural arrangements, religious, environments, socioeconomic norms, financial arrangements, and governances (Ghosh, 2016). Now, the world has become a global village, and the financial markets of the world are more integrated. The extensive review of the literature enables us to understand that financial globalization is a topic of discussion among researchers and policymakers. Different studies (Kim et al., 2010; Wang et al., 2019) provide different measures and determinants of financial integration. But none of the study has tried to link financial integration with globalization, economic misery, political instability, fiscal performance, and monetary performance in the case of South Asian countries. This study is novel and will be a healthy contribution to the respective literature. So, this study opens new avenues and ventures of research.

3. The Model

A sufficient amount of physical resources is necessary for an economy to smooth functioning (Ali, 2015; Ali, 2022), while the insufficiency of resources not only disturbed the route to economic growth but also creates many socioeconomic issues (Arora, 2001). Most developing countries have insufficient physical resources and this can be overcome by different types of injections i.e. foreign aid, foreign debt, issuance of currency notes without reserves, and financial integration. In the last few years, financial integration has got much importance among policymakers as it has a multiplier impact on economic growth (Solow, 1956; Romer, 1986; Mankiw et al., 1995; Ali, 2022), as capital flows from capital-abundant countries to capital scare countries. Financial integration is the process through which financial markets among countries are interconnected, and the barriers related to portfolio investment based on equity and debt, foreign direct investment, bank credit flows, and inter-state payment systems are removed (Eyraud et al., 2017). Financial integration is comprised of monetary integration, liberalization of the capital account, foreign entry and existence, harmonization, and convergence of regulatory levels. Literature also distinguishes between indirect, direct, and total integration among the countries. Different studies have highlighted different determinants of financial integration i.e. tax policy, exchange rate volatility, inflation rate, unemployment rate, financial development, economic development, economic growth, investment, legal environment, and level of institutions (Cheng and Daway, 2018; Ali, 2022). Globalization as a determinant of financial integration has been ignored in previous literature, thus following the theoretical framework of Stavarek (2012), the model of our study become as:

$$FI_{iT} = f\,(\mathrm{EM}_{iT}, \mathrm{Glob}_{iT}, \mathrm{FP}_{iT}, \mathrm{MP}_{iT}, \mathrm{PI}_{iT}) \qquad (1)$$

where

FI= Financial Integration

EM= Economic Misery

Glob= Globalization

FP= Fiscal performance

MP= Monetary Performance

PI= Political instability

i= Set of selected South Asian countries (Bangladesh, India, Nepal, Pakistan, and Sri Lanka)

T= Time period of selected countries (1996-2020)

For examining the relationship among the explanatory variables and explained variables, the mathematical model can be converted into the econometric model. The model can be written as:

$$FI_{iT} = \alpha + \beta_1\mathrm{EM}_{iT} + \beta_2\mathrm{Glob}_{iT} + \beta_3\mathrm{FP}_{iT} + \beta_4\mathrm{MP}_{iT} + \beta_5\mathrm{PI}_{iT} + \mu_1 \qquad (2)$$

where

α = intercept

β_i= slope coefficient

μ = white noise error term

The data of selected variables have been taken from the World Development Indicator (WDI). PP-FC, ADF-FC, IP&S, and LLC unit root tests have been used to check the stationarity of the variables.

Panel least squares and fixed-effect model have been used for examining the dependence of financial integration on selected explanatory variables.

4. Results and Discussion

This part of the study presents the estimated results and discussion. For examining the intertemporal properties of the selected variables, we conducted a descriptive statistical analysis. The estimated results reveal that data of selected variables have reasonable intertemporal properties, to further analysis. Moreover, data fulfill all the requirements of the balanced panel data analysis, as well.

Table-1: Descriptive Statistics

	FI	PI	MP	GLOB	FP	EM
Mean	35.66208	-1.293187	71.32333	49.17317	78.05917	3.901750
Median	35.29500	-1.220596	70.60000	49.82000	77.75000	4.055000
Maximum	57.19000	0.090368	81.80000	62.81000	88.90000	11.35000
Minimum	19.68000	-2.810035	56.80000	30.94000	63.50000	0.400000
Std. Dev.	9.651134	0.631794	5.013993	8.428811	5.845037	2.299938
Skewness	0.180758	-0.292579	0.055936	-0.355982	-0.140464	0.567960
Kurtosis	1.978213	2.953926	2.495639	2.245538	2.257637	3.362084
Jarque-Bera	5.873717	1.722663	1.334476	5.380532	3.150113	7.107091
Probability	0.053032	0.422599	0.513124	0.067863	0.206996	0.028623
Sum	4279.450	-155.1824	8558.800	5900.780	9367.100	468.2100
Sum Sq. Dev.	11084.18	47.50046	2991.675	8454.338	4065.570	629.4761

The results of the correlation among the variables are given in table 2. The estimated findings of the correlation matrix describe that most of the variables have significant correlation with each other, but all explanatory have very weak correlation, so there is no issue of multicollinearity among the explanatory variables. The estimated outcomes of panel unit root tests are presented in table 3. The estimated outcomes show that there is the same order integration among the variables of the model, which is the most suitable situation to apply panel least square and fixed or random effect models.

Table-2: Correlation Matrix

Variables	FI	PI	MP	GLOB	FP	EM
FI	1.000000					
PI	-0.052340	1.000000				
MP	0.031670	-0.214671**	1.000000			
GLOB	0.710841***	-0.044354	-0.156937*	1.000000		
FP	-0.392592***	0.037068	0.202273**	-0.192635**	1.000000	
EM	0.472743***	0.197402**	0.004662	0.389017***	-0.291068***	1.000000

Note: ***, **, *, 1%, 5%, 10% level of significance.

Table-3: Unit Root Tests Results

	At first difference without time trend				
Variables	LLC	IPS	ADF-Fisher	PP-Fisher	B-t-stat
dFI	-3.77428***	-4.21154***	36.3781***	72.4251***	-
dPI	-4.8411***	-4.0961***	35.6269***	50.1744***	-

dMP	-4.78745***	-4.27229***	37.1927***	54.6665***	-
dGLOB	-4.47392***	-3.67602***	31.7611***	31.5782***	-
dFP	-4.20042***	-4.80435***	41.7319***	76.296***	-
dEM	-2.91719***	-3.47162***	30.9073***	61.2354***	-
At first difference with time trend					
dFI	-3.03736***	-3.16474***	26.794***	60.3178***	-4.65256***
dPI	-4.58186***	-3.86936***	32.4165***	67.951***	-5.17181***
dMP	-3.60874***	-2.98133***	26.7047***	45.2436***	-2.55267***
dGLOB	-2.79733***	-2.04078**	19.1301**	31.4411***	-2.58981***
dFP	-3.57845***	-3.6106***	31.0549***	87.4308***	-5.03487***
dEM	-1.97297**	-2.41399***	23.6825***	74.982***	-2.8243***

Note: ***, **, *, 1%, 5%, 10% level of significance.

The estimated outcomes of the Hausman test have been given in table 4. The results show that the Hausman test is significant at the 5 percent level, this explains that the fixed-effect model is appropriate for our empirical analysis.

Table-4: Hausman Fixed Effect Model

Correlated Random Effects - Hausman Test

Test period random effects			
Test Summary	Chi-Sq.Statistic	Chi-Sq. d.f.	Prob.
Period random	67.833283	5	0.0000

The estimated results of panel least squares have been presented in table 5. The end of World War enables developed countries to establish such policies which can stable development and growth with the help of social, economic, and political strategies. It is the political environment that can impact the macroeconomic environment outcomes of the country. These are political stakeholders which have discretionary power to determine the expenditures and revenues policies (Rodrik, 2005). Thus, political stability is very important to decide the future of national institutions and their relationship with international institutions. But in the case of developing countries, this relationship is still unexplored and may have different outcomes as compared to developed countries. Conrad and Golder (2010) find political institutions play an insignificant role in deciding the financial performance of the country. Our results of the panel least square model and fixed effect model explain that political instability has an insignificant impact on financial integration. It is the domestic political environment that plays an important role in deciding the relationship between different countries. Political stability is one of the main factors that affect economic growth but also disturbed the financial transactions among the nations (Rodrik, 2005; Ali and Rehman, 2015). The elected governments have discretionary power to decide the international relations of the country, but in the case of developing countries, this is not true always.

Mostly, the financial systems of developed countries are integrated over the past three decades. This financial integration is accomplished with the help of many evolutionary business and policy practices. The rising financial links among the counties have numerous economic advantages, and raise the importance of monetary policy. Now there is well-established evidence that monetary policy is very vital for the financial process and national and international monetary transmission mechanism at the same time. The effectiveness of monetary policy hinges crucially on a set of parameters that can impact the level of financial integration among the economies. Our results show that monetary performance has a positive and significant impact on financial integration. Empirical studies show that any change in the policy rate, treasury bills, notes, and bonds have an instantaneous impact on the inflow and outflow of foreign funds. This explains that any rise and fall in monetary performance can bring the same type of effect on financial integration among South Asian countries.

Globalization is comprised of political, economic, and technological innovations that have changed the cultural, political, economic, and financial structure of the world. It is the process of globalization that raises the level of internationalization, integration, and interdependence among the countries (Maringe, 2010). In the last couple of years, globalization boosts the financial integration among countries and financial interdependence among the nations rise from 45% to 300% from 1970 to 2004. Financial globalization leads to the best allocations of resources among developing and developed countries. Our outcome shows that globalization has a positive and significant impact on financial integration in the case of South Asian economies. Due to the rise in globalization, financial intermediations respond to the demand for mechanisms to intermediate cross-border flows and partly a response to declining barriers to trade in financial services and liberalized rules governing the entry of foreign financial institutions into domestic capital markets (Askari et al., 2010; Potrafke, 2015). This explains that any change in the level of globalization directly impacts the level of financial integration.

Fiscal performance can improve the level of financial integration through various channels i.e. investment decisions are highly affected by the quality of macroeconomic policies, free capital movements may reward good policies and penalize bad ones and thus force national authorities to adopt a greater fiscal discipline. In addition, greater financial integration can also be interpreted as a signal that a country's authorities wish to introduce and follow sound policies (Bartolini and Drazen, 1997). Second, international risk-sharing by decreasing growth volatility may also lower government spending volatility. Third, financial integration can affect the composition of public debt by increasing the share of foreign debt. Our results show that fiscal performance has a negative and significant impact on financial integration in the case of South Asian countries. Different studies have linked fiscal policy and financial integration and found a positive relationship (Chinn and Ito, 2006). Due to the highly volatile socio-economic structure of the South Asian economies, there is a negative relationship between the fiscal performance and financial integration. Studies like Stulz (2005), Rodrik and Subramanian (2009) mention that the fiscal performance of developing countries is more central to political motives, hence, fiscal performance hurts the internationalization of finances.

The estimated outcomes show that economic misery has a positive and significant impact on financial integration. Financial institutions and financial markets play an important role in the process of allocation of funds and savings of individuals to production by reducing information asymmetry, and transaction costs and also reducing financial constraints (Ozturk and Karagoz, 2012). Financial institutions also can affect welfare through the minimizing of macroeconomic shocks (Kim et al., 2018). Being the more volatile economies, our selected countries have a positive relationship between economic misery and financial integration. The overall regression results explain that monetary performance, globalization, and economic misery are encouraging financial integration, whereas political instability and fiscal performance are discouraging financial integration in the case of selected South Asian countries over the selected period.

Table-5: Estimated Outcomes

Dependent Variable: FI		
	Panel least square model	Fixed effect model
Explanatory Variables	Coefficient	Coefficient
PI	-0.083083	0.940775
MP	0.350254***	0.176945**
GLOB	0.720752***	1.333687***
FP	-0.435754***	-0.137241*
EM	0.63481**	0.642882*
C	6.669374	-32.63986
R-squared	0.628623	0.93536
Adjusted R-squared	0.612335	0.911217

F-statistic	38.59319***	38.74282***

Note: ***, **, *, 1%, 5%, 10% level of significance.

5. Conclusions

Based on estimated results and discussion, this study can be concluded with major findings. The results show that political instability has a negative and insignificant impact on financial integration. Although political instability has an insignificant impact on financial integration, developing countries like South Asian countries should promote political stability for higher financial integration. The outcome shows that monetary performance and economic misery have a positive and significant impact on financial integration. A stable monetary system is not only necessary for domestic financial links but is also vital for international financial links. For better financial integration developing countries like South Asian countries should promote stable monetary performance. Globalization is positively and significantly impacting financial integration. This shows that globalization is promoting strong socioeconomic and political relationships among the countries, the more globalized countries are more integrated. Thus, developing countries like South Asian countries should promote globalization to attain higher financial integration. Fiscal performance has a negative and significant impact on financial integration. The role of government cannot be ignored, if the government is involved in economic and financial activities, this will discourage domestic and international financial activities. The estimated results show that fiscal performance has a negative and significant impact on financial integration among South Asian countries. This suggests that developing countries should minimize government involvement in economic and financial activities to achieve a higher level of financial integration. Economic misery has a positive and significant impact on financial integration among selected South Asian countries, this urges the selected countries to depend on foreign resources to gain financial integration. Thus, to gain financial integration at an equal level, developing countries to reduce the level of economic misery.

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