Abstract

The capital insufficiency in many countries and foreign capital's capacity to enhance domestic capital and promote domestic investments stimulate countries to take measures to integrate their domestic financial markets into the global financial market. Nevertheless, the nearly devastating contagion effects of the financial crises that happened in the recent two to three decades make people come to realize the dear cost of financial globalization, in particular in the form of short-term capital mobility, and cast doubt on the policy makers' decision to open up domestic financial market.

Based on the above background, this study focuses on analyzing the effect of financial globalization on host countries' economy using the European Union (EU) countries as examples. It mainly investigates how the influence of financial globalization could vary in different types of EU countries under different time periods. The covered time span is from 1995 to 2015. Fixed effects panel estimation methodology is carried out.

The study finds that not all parts of financial globalization are beneficial to economic growth and financial globalization can become harmful. Moreover, we find that FDI inflows should be a more reliable source of foreign capital than portfolio investments. Furthermore, based on the empirical results, we conclude that core EU countries benefit more from financial globalization in normal times while periphery EU countries benefit more from financial globalization during the time of crises and negative shocks. In addition, the study strongly supports the statement that a country with well-established domestic financial system is at an advantage in financial globalization. The well-established financial system assures the country benefit more from foreign capital flows in normal times while suffer less from financial crises or external negative shocks.

Given the results of this study, policy makers should design and enact policies that are attractive to foreign investors and that encourage FDI inflows into their countries. Moreover, they should implement appropriate regulations on the mobility of short-term foreign investment inflows, which requires policy makers to create effective institutions that are able to supervise short-term capital mobility and to periodically assess the adverse impacts of short-term foreign investment inflows on their economies. More importantly, the policy decisions made by the countries should be conducive to maintain domestic macroeconomic stability, political security and efficient governance.

Keywords: **Economic Growth, Financial Globalization, Financial Development, EU countries, Foreign Direct Investment, Portfolio Investment**