Institutions, Financial Integration and Complementarity

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We discuss the role of financial institutions in sustaining foreign borrowing by a country's private and public sectors, thus allowing it to benefit from financial integration. We exploit Gennaioli, Martin and Rossi's (2010) notion of complementarity, which arises naturally whenever public defaults are disruptive of private financial markets. By boosting private borrowing, strong financial institutions reduce the risk of public defaults and boost public borrowing as well. We build on this notion to interpret some broad patterns of financial globalization of the last 30 years and we briefly explore its policy implications.

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