

THE GLOBAL ECONOMIC CRISIS – WHAT WENT WRONG AND THE WAYS OUT

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Abstract in original language:

The current global financial and economic crisis is the most severe one in the modern history of mankind. Compared to any other previous events in this regard, the present situation is unprecedented while many causes lead to the collapse on the global level at the same time. The crisis started off in the developed world but the tremendous consequences of it are to be felt worldwide, and in particular in the developing countries. The exit strategies must be truly exit for all the countries, regardless the level of development and the new paradigm in the global financial structure must be found as one of the responses to this crisis.

Key words in original language:

Global financial and economic crisis; excessive speculations; commodities; interest rates; multilateral responses; systemic crisis; United Nations Conference for Trade and Development; developing countries; least developed countries; countries with economies in transition; liberalization; official development assistance; foreign direct investments; global financial architecture; impact of the crisis; global trade; global exit strategies; conditionalities; multilateral trading system; deregulation; international cooperation

Abstract:

Současná globální finanční a ekonomická krize je nejzávažnější v moderní historii lidstva. V porovnání s jakoukoliv předchozí událostí tohoto charakteru, je současná situace bezprecedentní, a to když globální kolaps byl způsoben několika příčinami najednou. Krize odstartovala v zemích rozvinutých, nicméně její dopady lze pocítit celosvětově, zejména pak v zemích rozvojových. Výchozí strategie z této krize pak musí být skutečně výchozími pro všechny bez ohledu na stupeň rozvoje a nalezení nového globálního paradigmatu týkajícího se globálních finančních struktur musí být jednou z odpovědí na tuto krizi.

Key words:

Globální ekonomická a finanční krize; nadměrné spekulace; komodity; úrokové sazby; multilaterální odezvy; systematická krize; Konference OSN pro obchod a rozvoj; rozvojové země; země nejméně rozvinuté; země s tranzitní ekonomikou; liberalizace; oficiální rozvojová pomoc; přímé zahraniční investice; globální finanční architektura; dopady krize; globální únikové strategie; kondicionality; multilaterální obchodní systém; deregulace; mezinárodní spolupráce

1. CURRENT GLOBAL ECONOMIC AND FINANCIAL CRISIS

The current global economic and financial crisis is often described as a „crisis of the century“¹ and definitely is the biggest and the deepest one since the 1929 stock market crash.² Indeed, these two events have basic distinguishing feature while the present crisis is a systemic one and requires the systemic solutions, partial corrections in this stage will not be helpful at all.

Generally, the downturns in the global economy are often of the cyclical nature and thus usually expected as natural. This is not true for the ongoing unprecedented crisis which is of very specific nature (imminently being preceded by the global food³ and energy crisis⁴ together with more and more important climate change challenges⁵) and is the biggest in the modern system of Bretton Woods's institutions as such.⁶

The present situation is in this respect totally incomparable to any preceding crises and is of very specific character while many causes lead to the global collapse at the same time and while the global recession has definitely the potential to undermine the economic growth of all the countries and the achievement of the goals agreed upon in the international community, such as Millennium Development Goals (MDGs)⁷ which should be achieved by 2015.⁸ The crisis itself erupted for the first time in the September 2007 and the question is if we have already seen the „end of the tunnel“ in the first half of 2009.⁹

It is also necessary to point out that there were private individuals (like one of prominent Libertarians, Peter Schiff)¹⁰ and institutions in the UN system (such as the United Nations Conference for Trade and Development since 2004)¹¹ that were warning the public before the possible impacts of the excessive speculations in currencies, global financial imbalances and

¹ UNCTAD Policy Brief „The „crisis“of the century...“, Nr. 3, October 2008, p. 1.

² For more details on „Black Thursday/Friday“events see for example: <http://eh.net/encyclopedia/article/Bierman.Crash>.

³ For the details see for example: <http://www.time.com/time/photogallery/0,29307,1731280,00.html>.

⁴ For the details see for example: <http://www.energycrisis.com/>.

⁵ For the up-coming UN Climate Change Conference see: <http://en.cop15.dk/>.

⁶ On the structure of the Bretton – Woods institutions see for example: <http://www.chebucto.ns.ca/Current/P7/bwi/cccbw.html>.

⁷ See more specific details on MDGs: <http://www.un.org/millenniumgoals/>.

⁸ UNCTAD The Global Economic Crisis: Systemic Failures and Multilateral Remedies, UN NY, Geneva, 2009, 64, ISBN 978-92-1-112765-2, p. 1.

⁹ UNCTAD Policy Brief „The „crisis“of the century...“, Nr. 3, October 2008, p. 1.

¹⁰ For the details see: http://money.cnn.com/2009/01/20/magazines/fortune/okeefe_schiff.fortune/index.htm.

¹¹ One of the first warnings can be found in the UNCTAD's Trade and Development Report from the 2004. See: www.unctad.org.

lack of rules in international finance. The expectations regarding the impact and extent of the possible crises have exceeded all the presumptions.

This contribution will not only try to characterize the present global economic situation which is not to be understood only as the crisis itself but probably more as an opportunity or challenge for the future international economic environment, but also to analyze the wrong steps that were taken in the history and that inevitably led to the present collapse. Finally, the intention here is to propose the exit strategies and steps that need to be taken in order to get back on the right track of global economic prosperity.

Three key elements of the crisis which are describing the present situation and thus distinguishing it from any previous crisis are to be enumerated as follows: the crisis originated in the developed countries (not surprisingly enough, the developing countries and the LDCs are the most severely hit), it is not a usual cyclical „incident“ (while the whole system collapsed), and it clearly pointed out that the present global financial structure and rules are totally insufficient.

2. WHAT WENT WRONG AND ARE THE IMPACTS?

This is a simple question that obviously does not have a simple answer. The nature of the present crisis is complex and thus also its causes must be viewed in complexity. Among them one can name: too much liquidity in the world, too many savings in one part of the world (especially in developing countries and countries with economies in transition that use this policy as a basic safeguarding mechanism and thus limit the aggregated internal domestic demand while restricting the amount of the liquidity in the domestic markets) and huge consumption on the other (especially in the developed countries – the United States and its internal market with strong banking sector can serve as a best example in this respect), individual misbehavior (famous cases of American bankers from Wall Street), lack of transparency in the international financial system (especially in the International Monetary Fund, World Bank etc.), lack of international agreed rules on finance (Bretton Woods institutions were not dealing with those at all) and the specific role of the credit rating agencies that were not subject to the market discipline (and their huge impact in assessing the quality of the whole banking sector and the lack of internationally recognized supervising agency).

The United States are often blamed as the „bad guys“ who are responsible for the recent state of the global economy. This statement (often used by the developing and the least developed countries in the traditional North/South trade „war“) is very simplistic and is overlooking some basic aspects of the current crisis. The turmoil on the financial markets turned out to be really visible (after years of relative calm) in the United States and in the sub-prime mortgage market – that is definitely true. In the global context this was only one single piece of the global „domino game“ that collapsed. The policy makers on the both sides of the Atlantic Ocean reacted quite promptly and calmed down the situation by the massive provision of the liquidity in the home market.¹² In the overall situation, these measures came late and were solving only the specific situation in specific countries (especially the United States and the measures taken within the Federal Reserve’s System and the European Union and the

¹² UNCTAD Policy Brief „Coping with financial market crisis“, Nr. 1, October 2007, p. 1.

measures taken by the European Central Bank). The main cause of the crisis, worldwide speculations in currencies and food, metal, oil and other primary commodities since mid 2007 – was underestimated in the name of omnipresent spirit of liberalism.

The post war system was based on unprecedented presumption that the full liberalization on global scale is absolutely necessary for the benefit of all.¹³ This presumption now turned out to be wrong one while the liberalized playing field allowed the speculators to create money in the huge shadow banking system while simply moving actives and passives on their balance sheets and thus simply only redistributing the debts world-wide and speculating in them.

Impacts of the crisis can be assessed on different levels and in the different areas. According to me these main different impacts can be distinguished as follows: demand driven deficit in international trade, deficit of credit and trade finance, falling commodity prices, declining remittances (coming from migrant workers), decline in foreign direct investments (FDI) and official development assistance (ODA) which can be tremendous for the developing and the least developed countries.¹⁴

Regarding the ODA afloat it is now clear that it will take years to recover it and make it again sustainable and predictable for the developing partners which are vitally dependant on it.¹⁵ The connection between the ODA flow and the crisis is more than clear while in most of the cases the donors set their aid target as a percentage of their own GDP – any single drop in GDP thus means automatically a drop in the ODA flow. For example during the last banking crisis the ODA dipped in the range of 20-40%.¹⁶

One of the strongest impacts of the present crisis can be seen in the FDI flows, the decline in the year 2008 and nowadays is obvious. The period of 2004-2008 is to be seen as the period of the growth cycle in international investments as such. The inflow of FDI reached the historic record; in 2007 the flow of the foreign direct investments reached the level of 1.9 trillion USD.¹⁷ The decline of the foreign investments was estimated as 15% in the 2008 and now is clear that this trend is about to continue in 2009 while especially the transnational corporations are feeling the real impact of the crisis with certain delay. This fall can be assigned to two main factors: lack of financial resources worldwide which is automatically capable to affect the investment environment and lack of trust while investing in developing countries that are most severely hit by the crisis.¹⁸ From the medium term perspective¹⁹ there

¹³ The ideology that clearly foretold the crisis in this respect can be summarized as follows: blind deregulation – unlimited self regulation – inappropriate regulation and capital account liberalization.

¹⁴ UNCTAD The Global Economic Crisis: Systemic Failures and Multilateral Remedies, UN NY, Geneva, 2009, 64, ISBN 978-92-1-112765-2, p. 1.

¹⁵ UNCTAD Policy Brief „Keeping ODA afloat: no stone unturned“, Nr. 7, March 2009, p.1.

¹⁶ Ibid.

¹⁷ UNCTAD Report on Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows – Advance unedited version, April 2009, p. vii.

¹⁸ Ibid.

are several aspects which will definitely play the role in restoring the FDI flows and confidence in the international investment environment. Firstly, new emerging economies that are still able to attract the FDIs will play more and more important role in the future (Brazil, China, India etc.). Secondly, the present crisis to be viewed as an opportunity for the cash-rich countries and transnational corporations to bargain the „ideal“ prices of goods and services. Thirdly, new sources of FDIs are already emerging – sovereign wealth funds and the importance of the south/south trade and integration is very clear in this respect. The real challenges for the countries is to continue to attract the FDI while the public investments programs, PPP programs (public-private partnerships) and bilateral and regional investment agreements might be helpful in this respect.

The aggregated impact of the crisis on the global trade is also clear now, especially taking into account the developing dimension of the trade as a mean of the future development or instrument that helps to fight the poverty and raise the living standards of the population.²⁰ The ongoing reduction of trade and investments is starting to restrain the development prospects of the developing countries and in particular the least developed ones.²¹ The most hit are the developing countries that are export oriented with the small economies where the reduction of international demand has tremendous consequences while these countries are much more exposed to the international markets.²² This effect can be seen not only in the area of trade in goods (where especially the automotive sector, telecommunication equipment sector and the textile and clothing sector are hit) but also in the area of trade in services (maritime transport, tourism, construction services etc).²³

One should not forget that the trade issues need to be assessed in a broader context. The declining exports have clear impacts in other related areas such as: rating unemployment (the sub-prime crisis in the global job market is tremendous)²⁴, declines in family incomes, child

¹⁹ UNCTAD Report on Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows – Advance unedited version, April 2009, p. 30 et seq.

²⁰ UNCTAD Report on Global Economic Crisis: Implications for Trade and Development (TD/B/C.I/CRP.1), May 2009, p. 3.

²¹ The situation is particularly dangerous in the context of the African countries. Africa is facing the systemic crisis for the centuries (trade in slaves, colonization, food crisis, oil crisis) but the present crisis represents the true human and development disaster due to the sharp decline of the commodity prices.

²² It is important to emphasize here that for the developing countries the most important markets are those of developed countries (Japan, the United States and the European Union).

²³ UNCTAD Report on Global Economic Crisis: Implications for Trade and Development (TD/B/C.I/CRP.1), May 2009, p. 13 (for trade in goods) and p. 20 (for trade in services).

²⁴ According to the International Labor Organization perspectives, there were 14 mil losses in jobs in 2008 and the estimated number for the period 2008-2009 is 50 mil losses in jobs. The predictions say that the unemployment rate will grow until 2011.

labor, extreme poverty in some parts of the world, the human rights issues²⁵ and gender equality questions²⁶.

3. THE EXIT STRATEGIES FOR ALL

In the present situation it is crystal clear that the market is not able to help itself anymore and the interventions coming from the national level (governments) and a real reconstruction and reform of the global monetary and financial institutional system (which failed mainly the good governance requirements) on the global level are absolutely necessary. The measures to be taken can be divided into two groups: short term, with the immediate impact and the long term ones. Public intervention is in the present situation absolutely necessary to avoid greater damage to the financial system and the real economy. The main challenges are definitely connected with strengthening the global financial regulations and increasing the transparency of the financial instruments and institutions. The first ultimate step is then connected with restoration of the confidence in multilateralism and identifying the proper strategies, both on national and international level.

The responses will of course vary country from country since some countries have naturally better “immune system” than others, especially in the case of developing countries (and in particular the least developing countries and countries with economies in transition that are totally dependent on the support coming from the international community) the situation is critical. These groups of countries are in the unprecedented situation while were pushed in last decades to open their markets, lower the tariffs and accept many conditions to enter to the cooperative monetary and financial system and thus get integrated in global economy. This is often described as a problem of the conditionalities which appear to be very counterproductive²⁷ in the end of the days. The critical point is this: especially the developing countries were trying to restore their international competitiveness while being exposed to excessive trade speculations; this hampered their ability to control the inflation rate. Now, it is clear that the cooperative financial and monetary system on the multilateral basis can only work when the same rules will apply to all the players in the playing field, just as multilateral trade rules under the WTO agreements apply to all trading partners.²⁸

The multilateral level is facing new challenges regarding the necessary rebuilding of vague financial multilateralism which clearly failed to be successful while being based, at least from the developing countries point of view, mainly on the system of conditionalities as described above.²⁹ In the recent age of globalization, the national economies are connected to each other so tightly that even despite the immediate efforts on national level to stop the crisis or at least to prevent its deepening, the crisis continues across the countries, regions, sectors and

²⁵ Especially trafficking in human.

²⁶ Women are primarily concentrated in the sectors that were mostly hit by the present crisis (especially the area of services – tourism etc.) plus they are usually in the bottom of the whole supply chain.

²⁷ UNCTAD Policy Brief „Will we never learn?“, Nr. 5, December 2008, p. 1.

²⁸ Ibid, p. 2.

²⁹ UNCTAD Policy Brief „Rebuilding financial multilateralism“, Nr. 4, October 2008.

activities.³⁰ The international community must recognize that no country can act in the isolation and that the truly effective system of global finance can be achieved only through predictable and rule-based multilateral framework.³¹

On the national level, stronger position of the governments and central banks in the financial questions is to be put in place. These are the only actors that can in the end of the days stabilize the markets and restore the confidence³² that was lost during the previous decades. Simply the role of the state must be rediscovered.³³ The main response on the national level dwells definitely in easing the monetary institutions and through that the overall economic situation, nevertheless, the immediate increase of the interest rates might penalize all market participants.³⁴ Especially all the “sick” financial instruments and their derivatives must disappear from the market (for example while issuing the state bonds as a part of the solution) – the pure cutting of the interest rates close to zero might not be sufficient in this stage. We saw so far the immediate reactions on the national level coming out in the form of rescue packages or decisions to bail out the financial institutions or the whole national market. In order to be really effective these must be followed by the regulatory consequences.³⁵ The eternal struggle between the concept of regulation and deregulation necessarily arises also here again.

4. CONCLUSION

The present global economic and financial crisis is truly unprecedented one and the ways out are to be found on the multilateral level in the truly multilateral system of global finance which will be based on the UN agencies ground. The specific needs of the most vulnerable economies (developing countries, the least developed ones and countries with economies in transition) must be taken into account seriously while these are the ones that are really paying the price in the end of the days. The old economic paradigm based on blind deregulation and liberalization is clearly not working out while the market is not able to control itself, at least not in the sufficient and sustainable way which will bring benefits for all. That is why the relevant stakeholders and players should search for a new economic paradigm and look at the global financial system from the very new perspective bearing in minds the needs for revitalizing, restructuring and rebuilding the current international financial architecture and institutions which turned out to be totally incapable to face the current economic state of play.

Literature:

- UNCTAD Policy Brief „Coping with financial market crisis“, Nr. 1, October 2007.

³⁰ Ibid, p. 1

³¹ Ibid, p. 2

³² This is often called the „credibility gap“.

³³ UNCTAD Policy Brief „The „crisis“of the century...“, Nr. 3, October 2008, p. 1.

³⁴ UNCTAD Policy Brief „Coping with financial market crisis“, Nr. 1, October 2007, p. 1.

³⁵ UNCTAD Policy Brief „The „crisis“of the century...“, Nr. 3, October 2008, p. 2.

- UNCTAD Policy Brief „Keeping ODA afloat: no stone unturned“, Nr. 7, March 2009.
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