

**GLOBALIZATION AND THE FINANCIAL CRISIS  
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The current financial crisis is looked at by many in a somewhat narrow relief. The crisis is viewed with a beginning, middle, and an end that started with the creation of sub-prime mortgages and the resultant investment instruments(CDOs, SIVs etc.) that grew out of them, and ending with the failure of those instruments and the repercussions to the economy, our reputation and finally the dollar. I believe the crisis needs to be viewed in a larger relief, as it is the product of the growth in global finance.

To truly understand how this crisis started, how to deal with it and, how to prevent another one of this magnitude or higher from happening again, we need to understand how the financial world has grown, and how other crisis's that transpired over the last 40 years were warning us of the one that we just recently experienced.

Let's go back to the 1970's when this country in particular experienced the "Oil Price Shocks" of gasoline prices moving from .28 cents per gallon to \$1.50 per gallon, many people including myself waited in long gasoline station queues for the privilege of paying \$1.50 a gallon to feed our 8 mile per gallon automobiles. OPEC had allowed the price of crude to float upwards from where it had been kept artificially low for decades. The inflow of capital into the oil producing nations created excess liquidity that needed to go somewhere. That "somewhere" was to the developing countries where growth was seen as a good bet, particularly since those loans "investments" into countries like Mexico Brazil and Argentina were projected to grow at enviable rates due to the discovery of oil in the Gulf of Mexico and the building of infrastructure in those

countries. Those loans were made with “petro dollar or hot money short term debt” placed with International Banks and cycled to those countries. When the world economy went into a recession in the late 70’s the demand for oil decreased, liquidity dried up, and the highly leveraged Mexico, Brazil and Argentina defaulted on their loans. Those loans were held by commercial banks that did not have the leverage to collect on those loans and thus took huge charge offs or reduced repayments. At the end of 1982, nine major banks in the U.S. had lent out over 287 percent of their capital to developing countries. With those loans not performing, commercial banks in the U.S. laid off thousands of international bankers and closed offices in the developing world. Stock prices for those banks tumbled and sovereign country risk for banks became a bad word and a career limiting experience. Commercial Banks from the developed world vowed not to involve themselves in the sovereign lending business, but in the future to only facilitate the flow of trade finance and corporate loans.

Trade Finance became the strategic focus for commercial banks during the 90’s, short term loans made to facilitate the flow of trade between companies, these loans were tied to the flow of trade and were therefore short term in nature and considered to be “self-liquidating”, you buy, I pay. Foreign Direct Investment increased exponentially as well, developed country corporations expanded globally, followed by their banks to assist them in their financing needs. The fall of the “wall” in Germany, the inclusion of Eastern Germany with Western Germany, the founding of the European Monetary Union with the expectations of growth, the rise of a non-communist Russia with its abundance of natural gas and petroleum to supply a growing world, and the arrival of a productive

manufacturing base in Asia led by China to supply the world with less expensive goods, heralded growth and wealth as far as we could see into the future.

During this growth period, foreign debt to GDP ratios of South Korea, Thailand, Indonesia and the Philippines rose from 100% to 167%. These countries were awash in liquidity, “hot money” seeking a high return in Asia with its new ability to supply the world with cheap goods. Many of these countries had a fixed exchange rate regime that worked well as long as capital continued to flow and they had customers to sell to, but as export growth slowed, the cash flow needs to service their debt did not. As their economies slowed, investors pulled investments and holdings in their currencies almost overnight. With liquidity disappearing almost as fast as it appeared, the Thai economy collapsed followed by most of Southeast Asia. As these economies collapsed, so was the risk that the largest commercial banks in those countries would as well. Had it not been for the much maligned IMF those banks may have failed as well. If the banks had failed, the funds in transit or on deposit at those banks from developed country banks would have been lost, causing significant write downs for developed country banks. This ‘counterparty risk’ with the growth in globalization causing a rapid increase in the movement of funds throughout the global economy with money owned by one bank being on deposit at a bank domiciled in a lesser developed country with less transparency and lax financial rules became of increasing risk to the health of the global economy.

Liquidity in unprecedented amounts, counterparty risk with financial institutions in developing countries represented globalization’s dramatic increase as developing

countries reached new levels of growth, and investments followed to take advantage of that growth.

The third warning sign, the current “sub-prime” financial crisis. With massive growth worldwide, continued low interest rates, money chased money across the globe. In order to make use of all the capital flowing into financial centers from Eastern Europe, China, and various other sovereign wealth funds as well as the continued modernization of financial systems around the world, new financial products were created to utilize this capital. Mortgages created for borrowers who did not meet traditional credit standards were wrapped into investment instruments insured against default and sold into the marketplace. Mortgages for everyone, NINJA Loans (no jobs, no assets, no problem) were created without regard for future repayment concerns. With China and India annual GDP growth rates in excess of 10%, why would there be a need to worry about an economic slowdown?

What was common throughout these crises was an excess liquidity fueled by artificially low interest rates, over-confidence in unsustainable economic growth, blind trust in a financial system not adequately supervised, and the inclusion of the developing nations inability to police its own financial system. These issues time and time again fueled an economic crisis that became more and more difficult to dig ourselves out from under as it increased in size and number of participants.

What can we do differently?

We know that developed countries have regulatory oversight, we are also aware that the regulatory oversight of financial systems in lesser developed countries is not at the standard of that of developed countries, yet we continue to trust in this global

financial system that truly does not have the teeth to protect our capital once it leaves the protection of developed countries. We have also seen regulators over stretched to enforce rules already on the books, shareholders with a “herd mentality”, creditors looking to do business over risk thresholds that they themselves had established. These has loose limits, opaque financial reporting, rating agencies not living up to their task has combined to create a global financial contagion. But we must remember, did any of us want this growth to slow, did any of us say “no I’m not looking for high returns, I don’t think this is right”, and governments were happy to see this global growth, more income from taxes rising real estate prices, continued asset growth. If government would have instituted new regulations to curb some of this growth, for instance not providing guarantees through government agencies to support poorly documented mortgages, would we have not said “get out of my business” “we don’t want more government regulation!”, yet now many of us are clamoring for more regulation.

What’s the answer?

Interesting question, anyone claiming to have the single answer, well, I don’t think there is a single antidote, no inoculation that will guarantee to solve the problems commented on above. We live in a time of enormous economic and industrial transition, what we do know is that there is no global governing financial body. We have financial rules in the U.S. and other developed countries that can be updated and enforced better for sure, but investments typically flow to higher returns, and those returns are where there is a higher level of risk in countries with a different attitude toward financial

transparency and regulation. And until we are all governed by the same well enforced rules, we will always face risk.