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PRESENT FINANCIAL CRISIS, A LOCAL VERSUS GLOBAL FRAMEWORK

ABSTRACT

Last fall at the Development Committee ad the World Bank chaired by the Italian Central Bank President Draghi, trying to work out some measures aimed to save the Western Economy, the adopted mission statement was: "We are concerned by the impact of the turmoil in world financial markets and the continued high prices of fuel and food. We welcomed member countries' commitment to take comprehensive and cooperative measures to restore financial stability and the orderly functioning of credit markets."

The last financial crisis, called also banking crisis as well, has really become something very peculiar and different from any previous classic recession or depression, as outlined in our classic economy models, Keynesians and post Keynesians ones. The present crisis determinants are located in a worldwide scenario and are connected in their mostly recurrent part to the unsolved monetary issues as expressed by Robert Mundel in his delivery speech at the Nobel price assignment in year 1999. Furthermore, the overlapping global economy has shadowed and outcast local markets and local production and the low fare Eastern Countries productions are invading globally all the markets. Since autarchy, protectionism and nationalism are outdated and not auspicial or repeatable, a soft integration may be reached trough a set of guidelines linking resources, population and global social target within a free continental development legal and institutional framework.

Key words: *financial markets, globalization, banks, gold standard, asymmetries*

JEL classification: *G2, G20*

1. ECONOMIC INTEGRATIONS, COMPETITION AND COOPERATION

Present Financial Crisis, origins effects in a local versus global Framework. Last fall at the *Development Committee* at the World Bank meeting, chaired by the Italian Central Bank President Draghi, trying to work out some measures aimed to save the Western Economy, the adopted mission statement was: "*We are concerned by the impact of the turmoil in world financial markets and the continued high prices of fuel and food. We welcomed member countries' commitment to take comprehensive and cooperative measures to restore financial stability and the orderly functioning of credit markets*."

The last *turmoil in world financial markets,* called also euphemistically *banking crisis*, has finally revealed itself as something very peculiar and different from any previous recession or depression known, as described and studied in our classic and modern economy models, Keynesians[1] and post Keynesians ones[2] and, according to my analysis is not a plane financial or banking crisis in its deep nature.

The present crisis determinants stem from a worldwide and historical scenario and may be connected, in their mostly relevant fundamentals to some unsolved monetary issues as expressed by Robert Mundell in his delivery speech at the Nobel price assignment in year 1999[3] and from some recent monetary miscalculation.

Referring to the 1921 Genoa economic conference, addressed to the regeneration of a *gold standard*, project firmly supported by Ralph Hawtrey and opposed by the young John Maynard Keynes and basically missed - according to Mundell - such failure lead to the second world war.

The previous 20 Century's unsolved financial turmoil lead both to the FED foundation in 1913 and to the first and second world wars, two global wars in a single Century, likely consequences of those unsolved monetary issues according to Mundell.

The twentieth century began with a long lasting efficient international monetary system, result of the Vienna conference and the aftermath of the British Empire after the defeat of Napoleon in 1815 when a world order was achieved.

Such system known as the *gold standard* was eliminated in the first World War monetary strategies, and its undecided recreation efforts during the last twenties and thirties generated the great depression, the autarchies and, as a consequence of the peace, the second World War.

The new arrangements and the multilateral clearing systems that followed relied more on the dollar policies of the Federal Reserve System than on the simple discipline of gold itself. When the link to gold was finally severed, the Federal Reserve System was implicated in the greatest inflation the United States has yet known, at least since the days of the Revolutionary War. Even so, as the century ends, a relearning process has created an entirely new framework for reinstalling some of the advantages of the system with which the century had began.

The century can be divided into three different sections:

- the first part, 1900-33, is the story of the international gold standard, its breakdown during the war, mismanaged restoration in the 1920's and its demise in the early 1930's;

[1] Hyman Philip Minsky, Longer Waves in Financial Relations: Financial factors in more severe depressions, 1964, AER.
[2] "The Global Consequences of Financial Deregulation", 1986, Marcus Wallenberg Papers on International Finance.
[3] A Reconsideration Of The Twentieth Century Columbia NY 2000. <www.columbia.edu /~ram15/nobel Lecture.html>

- the second part, 1934-71, starts with the devaluation of the dollar and the establishment of the $35 gold price in 1933 and end when the United States took the dollar off gold;
- the third part of the century, 1972-1999, starts with the collapse into flexible exchange rates and ends with the subsequent outbreak of massive inflation and stagnation in the 1970's, the blossoming of supply-side economics in the 1980's, and the return to monetary stability mostly based on the oil standard and the issuance of the Euro in the 1990's.

At Bretton Woods in the New Hampshire, the problem was eluded by the implementation of the *gold-exchange standard*, a necessary compromise between gold supporters and gold opposers which lasted up to the dismissal by the President Richard Nixon in August 1971. In that year the *gold standard* was unquestionably abandoned and we entered the present cycle of ever growing crisis between the *oil standard* and the Central Banks taking over most of the monetary policies the world around.

The core factors affecting the present financial crisis, after the 1987 unprecedented stock market crash, which lead to the Greenspan appointment at the FED, a strong supporter of the loose monetary policy then adopted in generously sustaining the credit market, may be presently ascribed to the following three major real causes:

- the second world wide trade liberalization, generally called as second globalization, understood as an effect of the end of the cold war;
- the existing asymmetries in local social, work, taxing and regulatory frameworks and fundamentally diverse welfare adopted standards, fiscal accounting rules, reporting and auditing practices;
- the progressive reallocation of industrial finishing production on a world basis from regional local markets toward Eastern and far Eastern nations pursuing the final target of a critical industrial size trough mass production, lowering costs on a global world competition prevailing over a single market trading approach.

Just to remind some of this special obstacle affecting fair competition on a global basis, we outline Western:

- labor protection stringent procedures, permanent training, updating and new implementations;
- privacy strict protective widespread procedures;
- illegal financial transactions activities monitoring and reporting costly procedures;
- law against illegal recycling activities;
- specific monitoring of financial transactions on behalf of the fiscal authorities;
- financial auditing and filing requirements;
- labour and enrolling preferred compulsory paths;
- unions strict political and social security monitoring attitudes;
- periodical labour contract renegotiations;
- obstructive dismissal rules and severance procedures.

Furthermore, the overlapping profitable global economy has overshadowed and downsized any local markets and production and the rapidly industrializing hosting

Asian countries have been globally outperforming in all the markets and the process has self enlarged and grown on a planetary basis.

The consequent US trade deficit, alone, jumped from $65 billion in 1993 to an average of more than $700 billion annually from 2005 to 2008, or about 5 percent of GDP.

Today imports from the Middle Kingdom, or Chinese Empire, and petroleum deficit account for nearly the entire U.S. trade deficit. Chinese and Middle East exporters use their dollar proceeds from growing large trade surpluses to largely buy U.S. bonds and property. That keeps long-term interest rates low, permitting Americans to borrow *recklessly and subprimerly* on homes and commercial buildings, and has been inflating property and stock prices in an enlarging derivative explosion, non overshadowed by any Central bank authority and misrepresented as technology and productivity booms.

At any of the Banking committee, held every six months by the Congress, Mr. Greenspan was assuring that innovation productivity was addressing price stability and non risk of inflationary factors was visible. Actually, the process was a subtle substitution of western likely more expensive industrial productions with less expensive Chinese and far Eastern reallocated merchandise numeric controlled productions.

The result is easily visible and measured from the evolving actual volume of TEU traffic from same origins and its enduring trend shift after the 9/11 attack as yearly published by the London Container Industry review, and listed in millions of Teu :

Table 1: Overall Traffic: first 20 ports by geographic area (year 2002)

Geographic Area	TEU traffic	%
Asia	84.951.148	65,89
North Europe	22.448.422	17,41
North America	14.381.242	11,15
Middle East	4.194.264	3,25
Mediterranean	2.954.571	2,29
Total	**128.929.647**	**100,00**

Source: www.ci-online.co.uk

Table 2: Overall Traffic: first 20 ports by geographic area (year 2006)

Geographic Area	TEU traffic	%
Asia	148.365.970	71,27
North Europe	30.020.396	14,42
North America	20.853.024	10,02
Middle East	8.923.465	4,29
Mediterranean	-	-
Total	**208.162.855**	**100,00**

Source: www.ci-online.co.uk

Table 3: Overall Traffic: first 20 ports by geographic area (year 2007)

Geographic Area	TEU traffic	%
Asia	170.334.729	72,24
North Europe	33.759.457	14,32
North America	21.045.404	8,93
Middle East	10.653.026	4,52
Mediterranean	-	-
Total	**235.792.616**	**100,00**

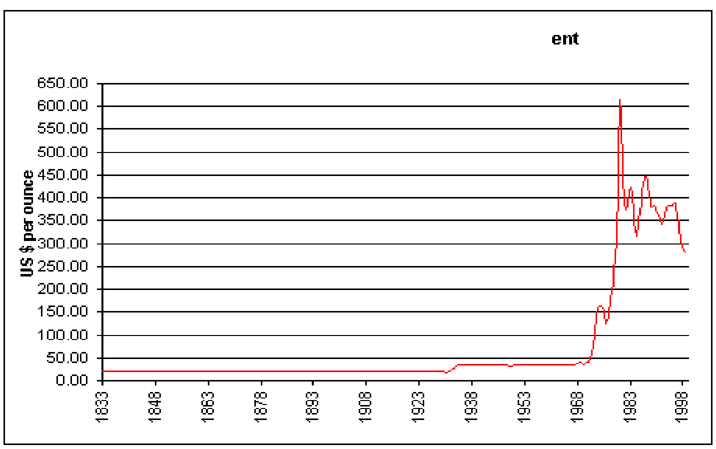
Source: www.ci-online.co.uk

The chronic Chinese trade balance surplus have systematically supported both the American deficits, the external and the internal one, trough the purchase of public debt treasuries and bonds and reallocating most of the excessive Chinese liquidity in North American banks without a proper risk caring monetary reserves diversification.

Bankers found, therefore, new ways and instruments to lend more against relatively small amounts of investor paid in capital, which should eventually provides their cushion against bad loans during a recession. They wrote *credit default swaps* - insurance policies - against loan defaults - that were generally backed by few if any assets. Financial investments houses and banks exchanged swaps in a grand *ponzi* scheme that may take a decade to clearly unwind.

At the beginning there was just the monetary crisis, which started with the definitive repudiation of gold as endorsed in year 1971 with a impressive effect on gold prices as fixed since 1933:

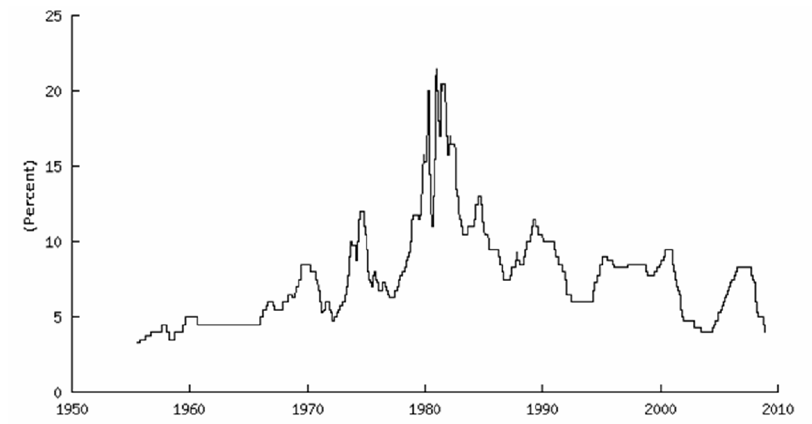
Chart 1: Price of gold as daily traded (London PM Fix Averages)



Source: www.kitco.com

From such a disarray of a long lasting price and exchanges stability, immediately the interest rates symmetric crisis was driven out.

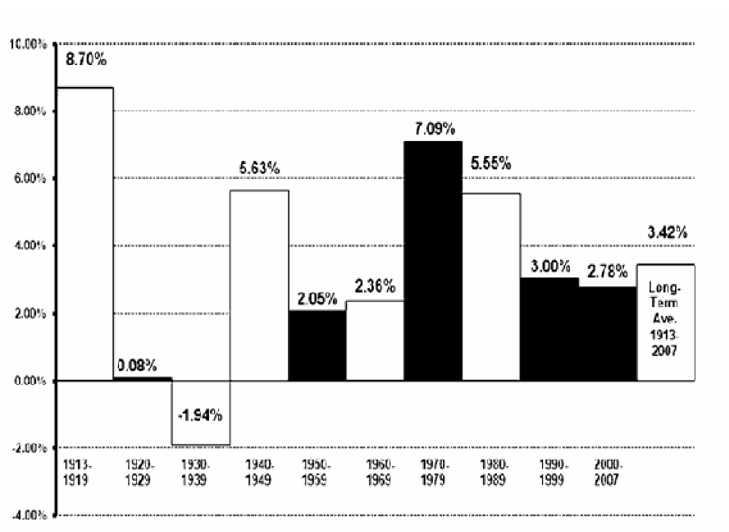
Chart 2: Bank prime loan rate (DPRIME)



Source: www.research.stlouisfed.org

The historical inflationary forces ensued on the side since 1913 – 1919 first world war period, further askew down the line closely reflecting both the deflationary and the inflationary prevailing policies and drives:

Chart 3: Average annual inflation by decade



:: www.inflationdata.com

Since autarchy, protectionism and nationalistic attitudes with custom barriers have been excluded after the 20^{th} Century records, at least in current present scenarios, and are not supported and seem unrepeatable, a soft way out of the present stalemate may be reached through a set of guidelines linking resources, population and global social welfare targets within a free continental enforcement of legal and institutional similar frameworks.

The economic case against protectionism is that it distorts incentives: each country produces goods in which it has a comparative disadvantage, and consumes too little of imported goods. And under normal conditions that's the end of the prosperity.

From an economic point of view, the final collapse of the *Gold Standard*, the undisguised market recovery of the late eighties, set in place in the year 1987, induced by the Fed trough a progressive lessening of the monetary policy, in connection with some tax, social welfare and reporting duties factors, have promoted a slow conversion of most Western productions by the East Asian tigers cheap manufacturing, confusing price stability and social imbalances with productive increase and technology progress..

The unreliable efforts to exploit new form of money standards and payment systems: from *bancor* to the *special drawing rights*, to the Ecu or *European currency unit*, and lately the *Euro*, with challenging Asian low wage countries competition growing in the last Century's decades, have lead a global imbalance in world split in an progressively more industrialized half hemisphere and a consuming but not producing or uncompetitive prices supplier other half world, while, due to the monetary crisis, the booming oil prices where inducing the huge energy common present issue.

The Americans made a historical plan for reforms that included a world currency called the unitas**.** At Bretton Woods in 1944 U.S. President Franklin D. Roosevelt told U.S. Treasury Secretary Henry Morgenthau, Jr. to prepare for an international currency to be implemented after World War II. Harry Dexter White at the U.S. Treasury formulated plans for the unitas.

In practice, up until the final collapse of the Bretton Woods system in 1971, gold itself filled this role, with the U.S. dollar fixed to gold at 35 dollar an ounce and many other currencies fixed to either the U.S. dollar or directly to gold.

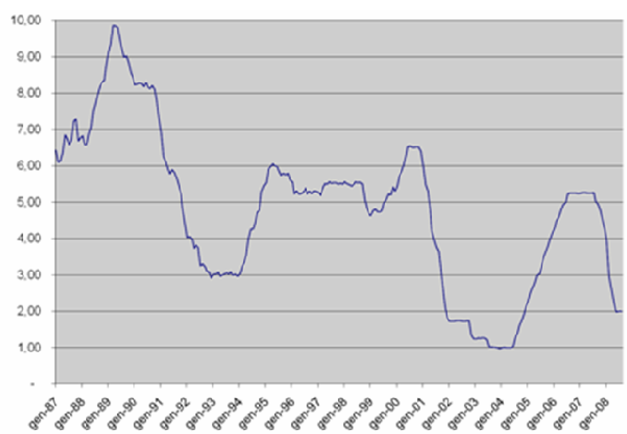
The 1987 market collapse was surprising most of the specialist observers and a reaction was to follow a loose monetary policy, on the contrary of what happened in 1929 when the return to gold was in full gear.

Chart 4: Stock market crash of 1987

Source: www.sniper.at

The consequences are now well famous and may be represented in the following charts:

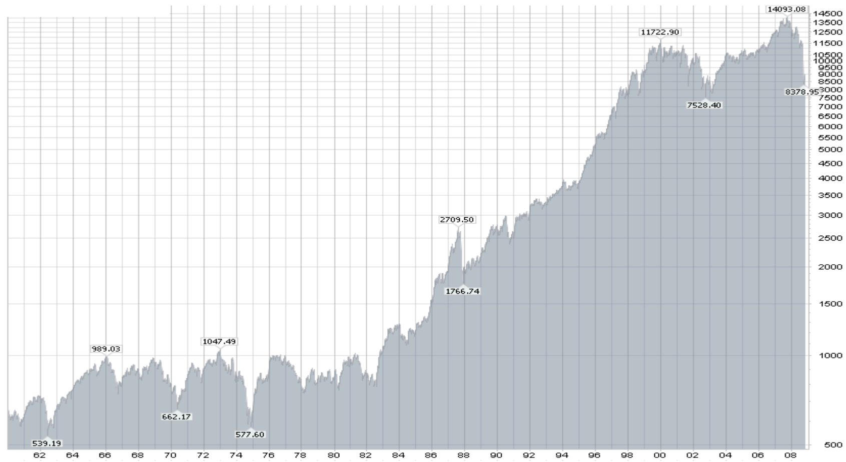
Chart 5: Fed Funds Rates, 1987 – 2008



Source: www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html>

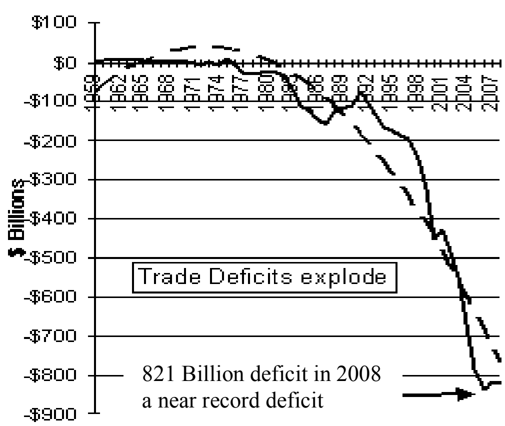
The Fed funds slope reflects both the bubbles formation and the bubble explosion, non considered under the prediction of *the soft landing* as a return to market price discovery function, after the monetary supply extravaganza was removed. Actually the Dow Jones reeached unprecedent and unthinkable levels and the inflation started to develop in the year 2004.

Chart 6: Dow Jones Industrial Average Index, 1960 – October 20th, 2008



Source: www.stockcharts.com

Chart 7: Merchandise International Trade Net Export-Import



www.mwhhodgeshome.att.net/reserves.htm

The figure reflect the huge growing of internal and external debts which are a clear and effective sign of what was the loose money policy producing. Since the then results appeared to look like

– an unprecedented huge trade deficit with global exchange disruptions and world-wide turmoil;

- a huge internal deficit with unprecedented outstanding US liabilities to most of foreign central Banks, especially the Bank of China which now owns almost two trillion of dollars;
- an energy dependency due to the self adjusting oil prices which reflect the gold price movements, almost stable in setting itself in a range of 5% to 10% of gold's price movements.

The idea to introduce the Euro as a reserve currency and to strengthen the European economic presence on the World scenario has faded as the Asian economies have undertaken a cost competition that has crowded out most of the western industrial production and stratified huge amount of US currency supporting the internal and external US deficit as well.

The world financial and monetary expansion has not been developed as an inflationary factor because of the productivity and technological asserted innovation, but mostly because of the Eastern low cost and competing growing quality standards and prevailing productions.

Within these angles, the continental integration seems a way to face a challenging economic struggle in an open and integrated trade space which requires large mass production capable of huge synergies and critical lowering of structural costs.

As the liquidity supplied by the Far eastern Central Banks on one side have supported the Fed policy and the credit potential, the repudiation of the 1933 *Glass and Steagall Act* and the adoption of the *Gramm - Leach - Bliley Act* in the year 1999, with the name of *Commodity Futures Modernization Act*, backed by the Treasury secretary Lawrence H. Summers, who supported the Clinton deregulation of the financial markets lead, on the other, to the aggressive lending to the mortgage market, to the explosion of financial derivatives and finally to a general slowing down economy, lead to the *sub prime* experience, and to the final fatal collapse of the financial markets when the Fe tried, unsuccessfully, to frame the inflationary symptoms in the year 2004 which lead to the first collapse of the financial institutions in the year 2007 followed by the fatal fall of both The Federal National Mortgage Association FANNI MAE, and The Federal Home Loan Mortgage Corp (FHLMC) Freddy Mac and most of the Investment Banks in 2008.

"*First you say you do, and then you don't. And then you will and the you won't. You are undecided now, so what are you gonna do?"*
- Undecided, by Sid Robin and Charlie Shavers.

This funny refrain reflects how Henry Paulson Jr. tried all the ways to find a solution on both sides of banking institution, the toxic bonds and the bad bank emerged but there was not a single common agreement about what to do and when do it. The World has been organizing meeting at top level with plenty of financial ministers but every one was promoting a different explanation and a different solution. Just today the G20 in London is discussing a new scheme without considering the titanic struggle

Unfortunately, Treasury Secretary Henry M. Paulson Jr. has turned this old song into the unofficial theme of *the* Troubled Assets Relief Program, the TARP $700 billion bailout. The frequent changes of direction are not only embarrassing, they also upset the very markets this program was designed to calm. The fact is that among so many choices, the Administration doesn't know how to solve the unsolvable problem of a declared banking system failure which is already history and probably cannot be solved. Either you declare inconsistent the assets, or the equity or you declare that the banks don't exist any more since they are insolvent.

2. CONCLUSION

So, the music is strong with the general financial and banking crisis but what really matters is the underlying crisis of the bank clients, either private mortgage borrower which are now unemployed or the large and small firms within the corporate banking, that are not able to service their scheduled payments as the fugitives are fighting toughly from the far East on rebates which are crowding out General Motors, Ford, Chevrolet as these are no global market players offering products like Lexus or Tata.

The Japanese liquidity trap has already shown the ineffective role of loose credit policies and all the twentieth Century Keynesian remedies has build up the hugest ever public debt mostly all over the Western world: it has been already a decade since the Japanese trade mark has disappeared from western shelves, if not made in *RPC* with BoJ keeping interest rates close to zero and now the continental Europe is facing a similar debacle in its automotive, electronic and durables markets.

This real problem has been surfacing now as a huge unemployment wave and as an overwhelming purchase power in the hands of mostly Oriental Central Banks. China, Singapore, Korea and Taiwan which has the largest vault of assets in the world history are facing a dilemma in avoiding a monetary collapse which could lead to a disruptive inflationary wave.

The general turbulence has been stemming from a two layers economy system: a local split set of national and regional market economies and a contextual expanding global economy, fighting each other over quality standards and price competition. The final solution lies in the mass scale synergies linked to the global single market potential and to the most effective social regulation infrastructure which must adapt to a new era, where the global versus local frameworks has one and only one downsizing solution. The asymmetries are there promoting delocalization, tough price competition and reallocation of producing facilities, for the moment being toward the East Asian areas, stressing the sinking Western production in a new World reshaping process. It is the largest structural crisis in the history of modern economies.

On the other hand, the huge monetary devastation of the twentieth Century are now surfacing in an unsettled monetary crisis marked by large exchange fluctuations, volatile interest rates and unknown fair market values as the money as understood in the General Theory has not bee working any more since the gold parity has been removed, opening new value eras as an unregulated oil standard or unreliable markets.

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