FROM CRISIS TO CRISIS?

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***Abstract**: This paper analyzes the effects of financial crisis, and points to the asymmetric of effects, which manifest themselves in at least three levels, i.e. between developed countries and countries with emerging markets, between industrial and financial sectors in the least developed countries. Attention is focused on the measures taken in the financial sector, whose crisis was the trigger of a global crisis and recession and whose new architecture should be the main backbone of the future system.*

***Keywords**: fiscal stress, quantitative easing, corporate euthanasia, recession*

INTRODUCTION

By thinking, people evaluate that this world is faced with serious value problems. Politicians are interested in power, and therefore pragmatic actions, and economists for economic growth and profit. Not taking into account moral and political issues of modern humankind burdened with inadequate answers, it is evident that the financial crisis in 2008 opened Pandora's Box from which all the bad things of the contemporary global economic system, especially global capitalism, came out. It pointed out to weaknesses of the current thinking of the economic system at national and global level. It shook the foundations of economic science and the quality of some existing laws. It has shown weakness in the estimates, in effect, but also proposed solutions too.

Is the world at a turning point? Do we live in a period of significant changes in the global economy? Whether the solutions offered so far give grounds for optimism? This paper tries to answer these questions by focusing on the solutions being offered in the financial sphere. Focusing on finances is the consequence of a general agreement that the banking and financial system as a whole should have the key, stabilizing role in the future system.

Optimism is not appropriate when we consider the number of failed attempts so far at the international level to begin to remove the key risks of the world. There are many, and among them, we should mention the failure of the conference in Amsterdam on global warming, little progress in multilateral trade negotiations in Doha, poor results in the UN Millennium Goals, little progress in redefining the Security Council or agreement on the proliferation of nuclear weapons.

SOME OPENED QUESTIONS AND OFFERED ANSWERS

The crisis has not passed within the period is anticipated. Although in 2010 growth rates in developed countries were recorded, they are relatively modest. Projection of world GDP growth for 2011 was 4.3%, while in developed countries will amount to 2.4%, while in countries with emerging markets is going to be slightly lower than in the 2010, but still with a high level of 6%.[22]

If we analyze recessions in 1975, 1982, 1991, and 2008, it can be seen that the effects of each of them were different. The biggest negative consequences of this recession were decrease in total exports and imports of 11.75% in 2009, decrease per capita investment for the 8.74%, drop in industrial production of 6.23 %, the decline of capital as a percentage of GDP from 6.18% and rising of unemployment in the developed countries of 2.56%.[23]

Coordination of the international community through the G-20 immediately after the disclosure of the crisis is conveniently operated in the direction of increasing confidence and mitigation of the effects of infection.[24]
The consequences of the crisis are asymmetric, geographically and sectorial.

This asymmetry is manifested in at least three levels:

The revival in three speeds In developed countries crisis characterize deeper, negative effects and to all projections will take longer, especially in EU countries, primarily due to debt crisis and the euro area in whole. Asymmetry of the growth dynamics exist among developed countries too. Countries with emerging markets are feeling the crisis in the reduction of economic growth due to reducing of aggregate demand in the world, but they failed to meet the high growth rates.

The second level is **the relationship of industry and financial sector**. Industrial production recorded a big drop and found itself before the necessity of its own restructuring. The necessity of restructuring can lead to dynamics of technological innovations, to contribute to the modernization of management and methods of reducing costs. There are attempts to find other solutions. For example, in Japan the approach of "corporate euthanasia" is obvious.[25] The oldest company in the world, Kongo Gumu, which began operations in 578 when it built a Buddhist temple, will cease to exist as other companies with century-old tradition. The reason is their lack of productivity and reduced competitiveness. The aim of corporate euthanasia is to create conditions for

[22] IMF, *World Economic Outlook*, 2010.
[23] IMF, *World Economic and Financial Outlook*, 2009.

[24] Nordic crisis served as a good basis for initial action into direction of minimum retention of confidence and strong state intervention in order to avoid panic behavior
[25] „*Corporate euthanasia*", The Economist , November 20, 2010.

increasing productivity. These activities may create additional tension to an already boiling market due to the rise of unemployment.

Financial sector, when it is developed, is stable and important for the real economy through increased investment and portfolio diversification. Through the distribution of different social groups and industries enables economic growth and lower costs. The financial sector was the immediate trigger of the crisis and it is also its biggest loser, if you analyze performance.

Bearing in mind the fact that catastrophic risks multiply, there are ideas to transfer them onto financial markets through the introduction of bonds related to the type of risk called Alternative risk transfer (ART) which can emit individuals, corporations, and governments to protect the predefined risk. Such bonds have been issued against the pandemic, terrorism, and natural disasters. The second form is the index of time representing the micro-insurance of farmers. These financial instruments shall be deemed to create a basis for providing capital to hedge of catastrophic risk.

Securitized products market (ABS, MBS, etc.)[26] has collapsed.

Different activities can be seen in the loan market. Loans have fallen in the countries of Eastern Europe in 2009, and in 2010, and to a lesser extent in country L. America.

Due to the large inflow of portfolio investments in the countries of South Asia and some countries in L. America has forced some to work to minimize the pressure on appreciation of their own currency exchange rate approach to the introduction of capital control measures (Brazil and China).

Foreign currency markets in turn recorded a resistance to the crisis. Daily turnover of traditional products in the foreign exchange market in April 2009 was USD$ 3.9 trillion, while on non-traditional instruments is estimated at USD$ 4.3 trillion. There are two causes: the first is that foreign currencies are seen as “asset class” investments, which, because of volatility in movements in exchange rates may provide higher yields compared to other investments. The second reason is the crisis in euro zone. A possibility that retailers, thanks to electronic trading appear on the market, whose share in total trade is estimated at 5%, could not be found among the reasons to explain the trading volume.

FDIs fell by 12% and according to forecasts, this important segment of capital flows will not revive until 2013. This is important for countries where FDIs are important for economic growth, but also to restructure their economies.

In the UK, there are ongoing discussions on the introduction of taxes called Robin Hood tax, which would imposed a tax on banks, and funds would be directed towards reducing poverty in the UK and abroad.

[26] Asset backed securities (ABS), mortgage backed securities (MBS)

In the direction of creating a stable financial system globally is generally agreed on the need to strengthen supervision by the state formed bodies, the increasing ratio of capital and liquidity issues, the retention of risk in securitization, as well as improving transparency on the OTC derivatives market, as well as the abandonment of keeping these sheet transactions off-balances.

New, complex measures and controls will force banks to increase the cost of capital or to decide to choose locations where there are less regulatory costs. Potential asymmetry in the regulations may result in unfair competition because it is recommended greater cooperation at the international level.

A shift in relations between the state and market is dramatic. Generous financial support at the beginning of the crisis continued in the form of "quantitative easing" i.e. inserting liquid assets on the market buying government bonds and other assets, both in the U.S., as well as buying in euro zone. Fed and ECB buy the bonds.[27] Monetary policy is expansionary and supports and other unconventional instruments of liquidity supply, which in addition to quantitative easing in the form of the promise of keeping interest rates low, or in direct support of dysfunctional markets. State provides other financial guarantees and financial injections to institutions.

Fiscal policy has taken a very important role in supporting the revitalization and stabilization, but due to imbalances and public debt issues, "fiscal stress" appears.

"Financial Repression" in 70's (McKinnon and E. Show)[28] has been replaced by "financial liberalization", which proves to be ineffective and that assumes a new approach to prudential control. Therefore, if to this is added to strengthening of the regulatory and prudential measures of the state, then the conclusion that the state of crisis strengthens its function and suppressed market. Still, countries are still weak, which among other things, is manifested in the persistence of illegal economy that involves the illegal trade (it is estimated that in 2009 was US$1.3 trillion and is increasing), as well as the persistence of organized crime and corruption.

A growing number of experts point to the fact that liberalization in the world of finance does not mean that in itself provides the depth of the market. Or that there is a necessity to support the liberalization of the appropriate policy environment that creates trust. In other words, "quality of political institutions and their credibility are necessary".[29]

[27] In the EU, the European Financial Stability Facility (EFSF) in the activities of the ECB through the Securities Markets Program (SMP) is created, which provided link between sovereign funds and banking markets. Therefore, until August 2010, ECB under the SMP has bought €60.8 billion of government bonds.

[28] McKinnon , Ronald I.,1973, *Money and Capital in Economic Development* (Washington, Brooking Institution), Show Edward S., 1973, *Financial Deepening in Economic Development* (New York, Oxford University Press)

[29] Marc Quintyn and Genevieve Verdier, "Trusting the Government", *Finance and Development*, December 2010.

After the debt crisis in Greece, which shook the euro zone and the euro, weaknesses in the EU became clear, mainly because appropriate measures in cases of non-compliance with Mastricht criteria were not provided. Sluggish regarding reactions has deepened the crisis and opened a number of speculative projections for the future relationship to the future of euro and relationship of this currencies and dollar.

The insistence by some experts that the EMU was created by political will was aimed to highlight the lack of economic conditions for constitution of optimal currency area in the initial phase and therefore was premature. However, although slow, responses that followed the political leadership of the EU shows that for now the question of the survival of EMU and the euro cannot be questioned, although the U.S. dollar increased its importance as a "refuge value."

What is disturbing is the fact that despite the efforts and spending cuts and restrictions, the ratio of debt to GDP in developed countries will be over 100% by 2014. The reasons are in the bailout i.e. financial support to banks and financial sector as a whole (which is a kind of protectionism) and fiscal stimulus. An additional reason is the unfavorable comparison of pensioners and the working population and a lack of government funds for the appropriate transfer payments. That it is impossible in a short period after the outbreak of the crisis to consolidate public finances and research suggests the earlier crisis and conclusion that return of public debt to 40% of GDP can be achieved in average period of 6-8 years after the outbreak of the crisis.[30] One of the imbalances is a high public debt of all major developed countries and the absence of these problems in countries on the emerging markets. Among the latter, there is a high public debt, and some of them have accumulated substantial foreign exchange reserves that make it appear as buyers of government securities in developed countries. In that way, they are better positioned for future international economic relations.

The crisis has shown the real balance of power of the world economy, whose changes suggest significant changes in the institutional solutions relevant to international organizations (Increase of IMF quota and changes in voting rights), but also actively participate in finding solutions within the G-20 and other international forums.

Long-standing conflict between the U.S. and China over the Renminbi rate intensified with the threat of an outbreak of the currency war. The war didn't broke out, but it is expected that the 2011 will be marked by constant tension around the USD exchange rate and China's currency.
Does the IMF and G-20 can take a key role and contribute to eliminating the imbalance? Will it be successful in the coordination of exchange rate regimes in order to avoid a currency war? Is it a better way to stimulate cooperation between creditors and debtors? Or both?

Economic disparities generally represent greater risk of global economy and the potential risk of various conflicts, including political and security. Insistence on the fact that surplus developed countries focus on market reforms in goods and labor, a deficit

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ones to fiscal consolidation, i.e. that surplus countries in emerging markets are engaged to directing demand towards domestic sources, a deficit ones on measures to ensure growth and employment, will be hardly achievable despite the logic.[31]

The third plane would represent **countries that do not belong to any group of developed countries and emerging markets, which are heterogeneous group**. They have common denominator, regardless of political systems that governs them, as poverty and high unemployment. The imbalance in the economic development potential is one of the greatest risks to global economic stability, and security in the world.

RESUME

Among the key players (G-20, Davos World Economic Forum) is the ability to detect global risks, but innovative solutions are not yet discernible, they are usually repetitive but known. The reasons are their complexity and the consensus of heterogeneity. Washington consensus is no applied any more, but an alternative was not given to it, which is also a sign of weakness or intellectual impotence.

It is certain that the globalization is changing its face. Even its biggest proponents and the winners take measures that could be classified into economic nationalism and populism.

O. Wyman[32] predicts the possibility of a financial crisis by 2015 that will be manifested in the creation of bubbles in raw material prices, which will hit banks that have invested in major development projects, then the American insurance companies in the U.S., and finally Western governments. The crisis of the banking system and the collapse of commodity prices will force governments to take measures of reducing costs. The key question is whether is possible to absorb a new round of deficit spending?

Threats to various risks and fear are leading paradigm for years on which the contemporary world function, and maintain the political structure in power. Predictions or warnings of this kind merit attention because their goal is that they are not realized or minimize potential negative effects in real time.

Unfavorable external environment in form of continuing to reduce the duration of aggregate demand, volatility of exchange rates, capital that is more expensive, the total uncertainty regarding the end of the crisis and the threat of new crises is posing new challenges to search for methods to increase productivity and competitiveness, and finding a route to market, domestic and foreign. Their experience along with synergy with the macroeconomic policies is probably the most efficient way to find long-term

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[31] J.Lipsky at the American Economic Association Annual Meeting, Denver, January 8, 2011, www.info.org, January 20, 2011.

[32] Oliver Wyman,» The Financial Crisis of 2015», *TradeMark FundMutualFund*. February 06,2011.

and sustainable positioning on the market, which is loaded and will be burdened with new surprises and crises.

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