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ECONOMIC GLOBALIZATION, RISKS AND RISK MANAGEMENT

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Abstract: *Risks have always represented a part of man's daily life and a component of his awareness, regardless of whether it is individual or collective, rational or imaginary, value or objective. This is precisely the thing that has, over time, weakened human confidence and strengthened his belief in the fragility of human thought. The problem, therefore, is not that the man lives in an atmosphere of risk, but the fact that many different risks (natural, economic, social, and especially technological) keep increasing, and their either latent and / or manifest consequences are becoming more and more dangerous. Many financial crisis emerged from misunderstanding risks. This paper aims to attempt and provide, in the prescribed form,a perspective of the process of economic globalization and the risks involved with this process.*

Keywords: *globalization, economic globalization, risks, risk management*

1. ECONOMIC GLOBALIZATION

Ever increasing entropic consequences of the progress on a daily basis assure man today that he practically lives on the "volcano of civilization," or, as some call it, within the raging technological civilization, whose top products might serve to destroy the very sense of this civilization. This serves to clearly outline the boundaries of our civilization, of which man is both the perpetrator and the victim. With the globalization of life and production processes risks are simultaneously globalizing,and this is nothing more than distribution of risk or distribution of problematic consequence of technological development. If both modern industrial society and modern times in general are faced the risk of progress, then postmodern industrial society as a whole is faced with constant progression of risks. By favoring quantitative growth and the related profits, power and prestige, this civilization wastes and destroys human and natural power and potential. Thus, at the same time, it systematically increases global risks. And it is exactly from the nature and extent and intensity

of these risks that we can read all the key components of modern philosophy of life. The consequences of the progress of science, technology and industrial development are actually "the sum of the risks and hazards whose achievements can not be fully predicted." [1]

The growing threat imposed the need to search for solutions that simply boil down to efforts to fully realize the risks (detection and identification of risk) and to establish more effective control and management over those risks. The aim is, ultimately, to eliminate or at least mitigate the potential consequences of risk. Hence, man's aspiration to master circumstances of his own life is understandable, i.e. it is man's wish to establish control over environmental factors - both external (natural and technological) and internal (biological, physiological and genetic).

Therefore, it is vitaly important (since, accepting the rules and way of life of this civilization, we have to live with the risk) that we constantly keep looking for the enlargement of opportunities and risk management. The key is, therefore, in the critical evaluation of risk situations (risk assessment) and risk management and assessment of social usefulness of mechanisms of risk control. In this respect we should also consider the key questions, such as whether it is possible and how precisely to calculatethe risk level of certain situations that represent social and technological frontiers of risky situations, and how to handle risk.

2. RISKS OF ECONOMIC GLOBALIZATION

From the global point of view, risks are usually divided into natural, technological and social, each of which in itself again contains numerous subspecies. Among them there are some similarities but many more differences. It is easier to classify natural risks. They just "happen", largely without human intervention. Due to their intensity, scope and consequences they often have the character of natural disasters. The most important risks of this kind are floods, droughts, earthquakes, storms. The general public does not need to know their causes, not the consequences.

Unlike with natural risks, the qualification of technological risks is more complicated, even though they are the center of attention. For these risks a matrix that would facilitate their systematization has not yet been fully developed. It is essential that technological risks are the products of human activity, because in today we actually live under the technological paradigm. However, although most of the technical-technological inventions, plant and processes by themselvesare not risks (unless abused), there are also those whose work will inevitably produce consequences that are harmful, and even potentially dangerous to human and natural environment. This goes for nuclear as well as conventional technology plants. This type of risk is generally not transparent to the general public. Moreover, the public often does not understand them. Therefore, it is essential that experts monitor and inform about the existence of risks and provide guidance as how to behave in certain situations.

We witness the increase in the new forms of threats to the environment, such as genetic engineering. In EU alone the member states reported more than three hundred of genetically modified organisms. Starting from 1990 the scientists have been working on a major project to decode the entire human genome (it is assumed that it consists of about three billion codons of a human genome). Despite the indisputable fact that it is a huge undertaking given the possible beneficial effects, at the same time it is also a risky adventure with possible catastrophic consequences. [2]

Social risks too include a wide range of potential dangers. The most prominent of these are the ones related to the problem of food and hunger (due to the increasing number of

population), related to the fear of the future, to large-scale social conflicts (wars, revolutions, terrorism). Misery, poverty and hunger in many parts of the world are dramatically expressed. One third of total deaths in one year are those who die of starvation. Wars are also extremely dangerous, whether based on ethnic or any other kind of social conflict. The more technologically imperfected the wars are, the more terrible their consequences. Although social risks, as a rule, take fewer human lives compared to technological and natural risks (such as industrial accidents, nuclear explosions, urban pollution, earthquakes, storms, floods), they in any case are not small.

Apart from the division to natural, technological and social, it is possible to present different risk divisions onto certain kinds and types. Thus, for example, with regard to their intensity, risks can be intensive and pervasive, with regard to age - old and new, with respect to the voluntary component - voluntary and forced, that is, selected and imposed on; further, risks can be known and unknown, with respect to the so-called probability they can be divided into highly probable and improbable (improbable in a high consequences, even catastrophic, and highly likely with little effect); with regard to duration - short-term and long-term risks with far-reaching consequences (High Consequence Risks) which can hit many people, even all the people on the planet.

3. RISK MANAGEMENT

Risk is always present in business life. Taking risks and risk management is part of the normal operations of the business in order to create value for the stakeholders. Many business failures, however, show that companies do not manage risk well enough or do not understand the risk they are taking. Such problems are not unique to large companies, because the analysis of the performance of around 200 leading financial companies in the period of 5 years conducted by McKinsey company showed that in 90% of cases there was a total of 150 cases of significant financial distress. Another study showed that approximately 36% of managers do not fully understand the risk, 24% believe that the processes in which the board evaluate the risks are ineffective, while 19% believe that committees have no defined processes for assessing risks whatsoever.

Ignorance of the problems of riskis generally exhibitedby high-level managers who traditionally concentrate on simpler metrics such as revenue after tax, earnings per share or expectations of growth in the stock market. Performances that would take into account the risk rarely appear as the subject of managers' analysis. Improving business management requires oversight by the board of directors and the integration of risk management into daily decision making. Companies that fail to improve their risk management processes have problems with another type of risk - the unexpected and sometimes very serious financial losses.

Companies can also take the attitude that is much more cautious towards risk, which would protect them from falling values and profits. Such an approach is not good because it is exactly the inclination towards risk taking that is the foundation for value creation for stakeholders. Therefore, the correct solution is - achieving a balance between the state which protects the company from financial distress, as well as leaving enough space for entrepreneurship. Management should have the freedom to work in conditions where the potential rewards of any business decisions are comparable with the risk taken. [3] In such an environment, companies can not only protect their business from unforeseen risks, but can also achieve a competitive advantage because they are taking risks but with caution. In

many industries, companies are beginning to invest in risk management processes, and the leaders of this are financial institutions motivated by regulatory pressures.

The primary functions of risk management start from the basic assumption that risk as such (either in corporations or banks) is independent of any business sector which reports to the CEO. Responsible manager leads a special sector that is responsible for the supervision of the implementation of risk policies. In addition, the strategy of financial institutions should be established and regularly revisedby the asset and liability committee, before being submitted to the board of the institution for the risk policy, in line with modern management principles. [4] Identification of risk exposure represents a set of analytical techniques to determine the elements of uncertainty through direct orindirect exposure to risk through liability to third parties, speculation and other market risk exposure. It is esssential that companies understand the risks they assume in order to be able to manage them properly. It is therefore necessary that all major risks are made transparent, in order to establish the type and amount of risk you are willing to take. Given that it takes a lot of time from these initial steps until we achieve corporate risk management, companies must also act outside of formal control to develop a culture in which managers automatically analyze both risks and benefits.

Another important element of risk management is to understand what risks actually are and how they affect the company's success. Every company is faced with its own variations of four types of risk, so it is necessary to build an individual approach to the development of risk management. For example, in the pharmaceutical industry, companies are facing the risks that affect the volume of business if competition bring better medicine, as well as higher operating costs if a product does not deliver the expected results. On the other hand, the company must consider how to categorize the R & D risk. The company must understand what kind of risk should be accepted, and what amount of money is at stake. It is also necessary to understand how risks of various business sectors affect the overall level of risk, i.e. companies need an integrated view.

The key phase of risk management is the estimate, i.e. assessment of risks in terms of determining the potential loss (in order to achieve a profit, it is necessary to take a certain risk). [4] The main task of the managers of banks, enterprises and other financial institutions is the realization of profit from current transactions with the application of active strategy which ensures a big turnover at the market, high yield, cost and risk as well as necessary fundamental analyzes of securities with active usage of modern computer technology. However, in the process of risk undertaking the size of the capital is decisive. In our conditions, the main intention of the operation of instruments and mechanisms for financing economic activities must be based on a shareholding basis and on the orientation to have intensive development of an integrated market, with complex treatment of market mechanisms. In this sense, it is necessary to have valid and realistic policy of financing of businesses, banks and financial institutions, with the aim of planning capital investments and financial evaluation of the efficiency of investment projects in order to maximize all values. Therefore, we consider financially acceptable only the capital investment projects where the discounted value of future net cash income is higher than the value of capital expenditures, i.e.where the net present value is positive.

Global financial and economic recession started, just like an avalanche, in 2008 with the spectacular bankruptcy of US private investment bank The Lehman Brotherswhich was faced with huge debt, both in banking and in bonds. By financing risky US housing market and by going into the complex debtor-creditor agreements and financial packages around

the world ("American global mortgage casino"), the bank was the first to feel what it means poor paying ability rating and what happens when the central bank does not come to the aid. This was followed: panic in the world markets, chain bankruptcy through domino effectsystem, rescue of certain banks by the state with taxpayers' money. Today in the US house prices and real estate continue to fall and are worth only 75% of the highest value that they had in 2006. It is estimated thatis in this crisis– either in stock markets or in the real estate, etc. – the world lost trillions and trillions of dollars, or roughly calculated the entire world's annual gross domestic product, despite the fact that at least 10% of the same GDP was pumped into the system rescue of great crisis. On the other hand, we are richer for a great experience, especially when it comes to risks, mutual trust, health of the financial structure, existence of limits to profit and greed. In fact, in this country we have a saying referring to this kind of hazardous behavior driven by greed: "Our house shall burn down too, so we too shall have nails." Whether the crises are inevitable because theyare inherent to the capitalist system, and whether a different approach might have prevented the crisis or at least mitigate it, will be discussed below.

It is necessary to establish a relation between the interruption or reduction of financial activities (financial crisis) and the crisis as such, as well as determine the extent of risk affecting the economic activity. The above distinction is important, because a large number of our contemporaries, especially in the United States, has been lately promoting the view that the chances of the emergence of the global crisis tend to zero, which is not true. It was believed that only interruptions financial activities could happen, and as the argument they used the fact that these interruptions in the last thirty years had been successfully repaired all over the world, that it was not allowed for any crisis to spill over into the world economy, and that there were no consequences on a global scale.

The main difference between the concepts of disruption of financial activity and crisis relates to the scope of the crisis While crisis affects the entire economy and equally affects almost all industries, interruptions in financing activities are reflected, at least initially, only in the financial sector. In essence it is a loss of confidence in certain assets or the financial system, and the result is that investors withdrow their funds. It is important to point out that – unless we seriously consider and treat the causes that led to the financial disruption - the situation may get out of control and turn into an economic crisis, which is identified as a period of extreme danger or difficulty.

In each financial institution there appear several types of risks, and the easiest way to manage them would be at the aggregate level: the level of the whole organization. Unfortunately, the practice has shown that this is impossible. There have been several attempts to measure the risk level of the entire institution, but the results were not usable. Although they gave a good overview of the risks assumed by the institution in the past, by using these methods it was not possible to define a desired profile, or to determine the current level of risk. The current methodology for risk management implies the bottom-upprinciple in which risks are measured at individual positions, then at the departments, all the way to the top of the organization.

In normal operating conditions traditional risksoccur, which include credit, market (interest rate and foreign exchange), operational and liquidity risks. Until the 80s of the 20th century, interest rate risk used to be analyzed only at the aggregate level. By increasing the number of financial instruments, their more extensive involvement in the affairs of trade and interdependence of financial markets, joining other factors, such as exchange rate, market price of shares and other listed goods, new risk has appeared - market risk. Investment

banking is the most widespread form of banking in the United States, and it is logical that most of the models for measuring market risk originates from there. Although models for risk management do not eliminate uncertainty, they help to identify, analyze and evaluate risks, to ordain a rational strategy, define the desired level of risk and achieve the required profitability. Bankers Trust was the first financial institution that got engaged in developing models for managing market risk through the creation of the first Academy of risk.

In the early eighties of the twentieth century they understood that when assessing the effects of business they must also include the loss, i.e. the possibility that there may be irregular servicing of obligations by clients. In this regard, the RAROC model ws constructed-which subtracts the possible loss from the expected profits, and this category was named'risk adjusted businessyields.' By purchasing the Bankers Trust, the JP Morgan institution has continued to develop the aforementioned model, and later developed its own methodology RiskMetrics. The situation with the credit risk is completely different. Portfolio model for its measurement was not developed for a long time because the credit risk used to be analyzed by using the financial statements. [5]

Since the notion of operational risk is quite wide, the new risks are often classified under operating risks, and they are due to changed business conditions. However, most banks opted to include legal risk into the definition of operational risk,but failed to include strategic and business risks that are separate entities now.

In the conditions of financial crisis, when thereis interruption of financial activities in the market, two more risks appear: assessment risk and macroeconomic risk. Assessment risk affects individuals or institutions, investors, in terms of uncertainty of return on assets they own, especially if their instruments are complex and the assets from which they are derived are amorphous. In the current global crisis, this risk was evident in re-establishing the value of assets that many banks held in the balance sheet, which were derived from the subprime mortgages in the US market. Reassessment of the value of those assets was necessary to determine how potential losses in the mortgage market affect the value of the portfolio containing derivative securities. Doubtful assets are exposed toassessment risk because until September 2007, write-offs of receivables at the global level reached 760 billion US dollars. [6]

Systemic risk is the most dangerous risk that arises in the course of the crisis, and Sinkey definesit as the uncertainty associated with the collapse of the financial system. [7] It occurs due to excessive credit, market or operational risk in an institution or in a market, and it spreads to other institutions (markets) and eventually swallows the entire financial system, causing the so-called domino effect and disruption to normal operations. As the systemic risk depends on factors that influence the whole market, it cannot be diversified and there are no methods for its management, apart from controlling the main risks.

Corrigan and Krugman have identified factors that increase the likelihood that the financial crisis spreads into the global crisis. [8] The most important factor is the macroeconomic policy. The consequences of inappropriate macroeconomic policies over the past few decades of the USA as the world's largest economic power have resulted in the current crisis. High inflation rate had led to unrealistically low interest rates and high internal and external debt, which coincides with the over-indebtedness of both comercial and sector of population. The constant need to affect international trade, liberalization and coordination, as well as the attempts to control foreign exchange rates, have constantly increased the risk of global economic crisis. Inadequate macroeconomic policies has created the climate in

which it is easy to identify patterns of behavior and action that promote and encourage risk, and lead to economic crisis.

No less important factor is the concentration of activities in terms of targeting the same type of clients (second-class customers in the United States during the last fifteen years), focusing on the same type of products (mortgage loans and securities derived from them in the current global crisis), and investment in only one sector of the economy. Further, Krugman recognizes the short lifespan of highly profitable financial innovation as a structural factor in the crisis. Namely, as financial innovations are easily copied, an increasing number of participants appears in their trade in order to achieve significantly higher profits. Unfortunately, new participants are often ignorant, and their only motive to engage in trade is a quick and easy profit. To the above mentioned issues we must also add the problem of "apparent liquidity," because all of the participants think that they are the most capable and brightest, that they have the right information and will derive the most benefit from the transaction. Unfortunately, in practice, the investors who last enter the market are the last coming out from it with huge losses when the problems have already emerged and accumulated. [9]

The fourth factor is the increase in the number of loans that are not regularly serviced. Due to the decline of all major macroeconomic indicators, falling purchasing power of all economic entities in the first place, a significant number of clients is no longer able to regularly service their obligations. However, we should not forget the good old greed and immorality, as well as the weakening of regulations, supervision and capital standards which encourage risky investments. It further contributes to increasing pressure on systemic risk. Here we must inevitably add another factor, systemic dependenance of financial markets and institutions around the world and their lack of transparency.

Trend of intense financial globalization has led to structural changes in the financial sector. They affect and change the nature, understanding and ways of managing risk. The probability for the occurrence of the risk is increasing due to the nature, speed and complexity of the credit, market, and operational interdependence of global markets and institutions. When the risks taken exceed the ability of the financial system, there is a market shock. Investors withdrow from the market and create interruptions or slowing of financial activity. The risk remains in the form of a structural problem, but probabilities change. The risk keeps increasing and there are new types of risk, assessment risk and macroeconomic risk, as discussed in the previous section. In this regard, in order to reduce the probability that the interruption of financial activities turns into a global crisis, various international and domestic regulatory bodies create appropriate instruments and policies.

Many financial crisis emerged from the risk of misunderstanding. In this sense, Helvig, as sources of the crisis identifies the inability to recognize risks or inability tp connect riskswith a certain business segment. [10] The point is that each business segment has specific characteristics regarding the risks that are taken, therefore, all the details are to be included in the risk analysis and taken into account in the models.

4. CONCLUSION

The ever more evident entropic consequences of the progress on a daily basis assure man today that he practically lives on the "volcano of civilization." Risks have always been part of man's daily life and a component of his consciousness. Over time, it is precisely this that has weakened human confidence and strengthened his belief in the fragility of human

thought. The problem, therefore, is not that man lives in an atmosphere of risk, but that different risks keep increasing and their latent and/or manifest consequences are becoming more and more dangerous.

If the financial crisis is not tackled in the short term, the effects will spill over to the real sector of the economy, causing a decline in all macroeconomic indicators. In such a situation, because of the linksbetween financial and real sectora, we enter into circular rounds of backlinks. This phenomenon, known as the financial accelerator, is dealt with by the makers of monetary policy, in order to maintain monetary and financial stability. Bearing in mind that all of the models for risk management and risk reduction are constructed in periods of stability, risk management in times of crisis is crucial because certain model parameters have changed.

In the event that a financial crisis turns into a global one, when the risk undertaken goes beyond the capacity of the economic system, the type and extent of the risk is significantly increased, homogeneity of the group disappears and the risk turns into uncertainty because the probability in that case becomes pure guessing. The causes of uncertainty are varied. They range from political and international influence, the process of transition, the development of technology and new products and services, poor models for translating uncertainty into risk, etc. In conditions of uncertainty, not only new types of risks appear, but also the existing once become reinforced and operating results are no longer solely in the hands of management.

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