The Globalization in the Crisis Context

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Abstract

The succession of the crises back in the years ’90, in Mexico, followed by Thailand, Indonesia, Korea, continuing with Russia, Turkey, Brazil and the last but not the least, Argentina, let many analysts to allege that these financial crises are an inevitable result of the globalization. The issue behind this analysis consists actually of the fact that, due to this phenomenon, the financial management problems became more critical.

Key words: contagion, crisis, development, nation, problem

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1. General aspects

Obviously the crises would have not reached an uncontrollable level and would not have expended, if they had not been exposed to the exposure at the international capital markets. Meantime, the growth rhythms recorded by these countries would have not leveled up to such amplitude if the financial flows, generated by the globalization had not existed. All these crises hold more complex reasons, belonging to the interactions existing between the national policies and the international financial system. At the national level, even if many of the countries recorded quite impressive developments from the point of view of the economic performance, there have been not, however, the necessary key factors for an effective protection against the shocks coming from the international markets. Here we have the contagion phenomenon occurring that is typical to the process of the interdependences increase between nations. The contagion consists of the transmission of the economic or financial shocks between nations, either the positive or he negative ones. Frequently, the contagion notion is correlated with the negative periods, while the “spillover effects” are correlated with the positive phenomena. The contagion suggests in fact that the correlated evolution of the nations, frequently explained through the herding effects behavior. The crises contagion at regional and global level holds several channels of transmission that consist of the fundamental connections between the world’s economies, among which we emphasize:

- the financial connections – they do exist whenever two or more economies are connected through the international financial system. For instance, the payment incapacity of a country may affect its main creditors; if the connections chain is longer, then the shock may be transmitted several times. Another example: If an international company or a mutual fund is recording decreases of their market values, running the risk to become insolvent due to a negative shock from a country, then it is obliged to create reserves by selling its assets on a market not affected by the initial shock.
- the connections of the real economy – refers usually to the international commercial relations. For instance, two partner or competing countries on a third market will be negatively affected if one of them is facing or is resorting to the exchange rate devaluation, which will deteriorate the competitive advantage of the other country.
Consequently, both countries will resort to successive devaluations, with the purpose of re-balancing their external balances. Meantime, the real connections occur as direct foreign investments as well.

Political connections – are explained to a lower extent by the specialized literature. Let us consider the following example: if a country is member of an association or “countries club”, with a particular monetary arrangement, the political costs of the unitary devaluation are by far smaller if the other countries are resorting to the same step. This is why, the crises tend to concentrate themselves in the regions of major interdependences.

The conclusions arising from the contagion effect of the financial crises implied the need to estimate the external vulnerabilities of these countries before they proceed hazardously to an irrational liberalization of the capitals. The macroeconomic stabilization, the financial health, the transparency of the government policies proved to be fundamental elements for the participation on the global market.

2. The increase of the country risks in the new context of the globalization

The end of the last decade knew strong degradations of the country risks, as it has been shaken by numerous financial, stock exchange and currency crises. The country risk is a macro-risk, meaning that is the result of the evolution of the general conditions of the national economic environment, having a major impact on both the external crediting of the respective country and the private investments.

Presently, there is a large number of systems for the risk analysis, the most well-known being the models utilized by BERI (Business Environmental Risk Intelligence), by the American rating agencies "Standard & Poor’s", "Moody's", Fitch IBCA, "Duff & Phelps", as well as by reviews such as "Euromoney" and "The Economist". They are grouping the countries by classes of risk starting from the principle that the countries of similar levels of risk tend to record a similar macroeconomic evolution. Frequently, the country risk is associated to the risks premiums running on the financial markets for the granted credits and for the bonds issued by a country, or to the de-quoting rates for the debts instruments on a debtor country, although, in some specialists’ opinion, the level of the country risk should bear a guiding role only, as regards the evaluation of the financial rating associated to a state.

The last researches on the worldwide plan, reached the conclusion that the risk premium (the difference between the interest applied by the crediting banks and the LIBOR interest), off which the estimated rate of the creditor’s loss in the situation the country risk is occurring is deducted represents, in fact, a country risk premium. This risk premium is calculated depending on the following variables: the credit duration, the probability of re-spreading out the payments or to repudiate the external public debt and the demand elasticity. Meantime, the country risk premium can be calculated in the form of the linear regression of the following independent variables: debt/GDP, foreign investment/GDP and the rate of the foreign debt service. Another alternative starts from the premise that the county risk is equivalent to the market risk for each investor who holds a portfolio on the respective financial market, under the conditions that the national financial market is reflecting the economical and political developments of a country. This approach has a higher relevance for the portfolios formed in the developing countries and on the emergent markets. Another approach considers that the country market is given by the volatility of each national market as against the international market of the financial equities. This manner is relevant for the portfolios formed in the developed countries – the relevance of the market risk coefficient being reduced in the case of the developing countries.
In the year 1998, the country risk recorded the highest amplitude of the last five years. This increase of the country risk all over the world (the years 1997-1999) is, certainly, the most significant since the one recorded in the years '30 and '80. The Asian crisis of 1997, which focus was Thailand, extended rapidly over all the Asian economies (the ASEAN countries followed by the North Asia countries, South Korea in particular), expending then over the entire world economy, showing various ways of acting:

- very powerful financial crises in Indonesia and Russia, resulting in heavy devaluations of the national currencies and a moratorium on the Russia payments (August 1998);
- very strong speculating attacks on Brazil;
- the Central and East Europe countries, the Latin America countries, Turkey and South Africa have recorded numerous collapses of the stock exchange quotations and the exchange rates.

The emergent markets have been more severely affected than the mature countries. Out of these last ones, the bonds market in the USA and those of “hard core” from the European Union had even marked the benefit to return to quality. But the country risk worsened in numerous developing countries and should various forms of acting:

- sovereign risk and non-transfer – Russia, Argentina;
- systematic risk of the credit - Korea, Indonesia, Thailand;
- systematic risk of the financial markets – South Korea, Indonesia, Malaysia, Philippines, Thailand.

The evolution of the emergent countries during the last years of the passed decade shows that an extension of the investment opportunities in these countries has been accompanied, in fact, by an increase of the country risk, mainly through an increased potential of the international propagation of the crises. This resulted from the increased vulnerability of the developing countries and from the persistence of the structural lacks of balance.

Although the Central and East Europe, candidates to the EU adhesion are globally positioned on the international economical scene, in a particular way, they were not entirely sheltered against the contagion, directly or indirectly, of the Russian crisis of 1998. The shock coming from Russia resulted, with rare exceptions, in:

- the strong collapse of the stock exchange indices (almost by 40% in Budapest, between Aug. 14th – Sept. 14th 1998);
- currencies depreciation (by over 8% the Polish zlot in one month);
- diminishing the international reserves (almost by 10% for Romania, between July – Aug. 1998).

Presently, these indicators recovered for the majority of the countries, underlining that the lack of confidence concerning the emergent countries and the countries in transition lost in intensity.

The Russian crisis, as well as The Asian one a year before, spread panic among creditors and investors. Although the country risk analyses played well their predicting role, identifying the crisis focuses, the investors on these markets underestimated the level of the risk associated to the high level of the provisioned yields. The amplitude of the Russian and Asian crises, as well as the Argentinean one, was due to the increasing gap between the risk evaluation of the economists and the investors’ optimism, which led to the occurrence of the “optimism bubbles” – a sign of risk of confidence crisis, as these “bubbles” had rapidly deflated, turning into “pessimism bubbles”. These crises had a double impact, first financially and then economically, due to the markets diminishing and
the increase of the bankruptcies number. In three of the four recent shocks (Thailand, Korea, Russia) the preceding disconnecting between the perception of the risk by the markets and the country risk indicators. The crises are well preceded by a period of excessive optimism as against the actual situation of the economies. But Indonesia did not match with this scenario as the adjustment of markets confidence level to the economic situation was instantaneous. In the case of Brazil, it is obvious that the tensions translated mainly into an excess of lack of confidence that get corrected afterwards.

Excesses of optimism arouse in South Africa, Turkey and newly Venezuela, without any adjustments ever taking place (excepting the drop of the South-African rand in 1998). In exchange, Argentina, Venezuela and Hungary, before the Russian crisis, have suffered a confidence deficit. Generally, this is tending to auto-correct, through a gradual amelioration of the perception of the risk by the markets. Absolutely exceptionally, a degradation of the fundamental aggregates is observed in China and Philippines, and not only, where the markets fear for important repercussions of the Asian crisis preceded their actual apparition in the foreign trade statistics.

But the year 2000 marked a strong recover of the country risk all over the world, counting for the year of the highest rate of the world economy growth and of the foreign trade of the past decade. Moody's granted more favorable rating during the years 2000 to countries such as Mexico, Canada, Israel, Malaysia, Thailand, Hungary, Russia, Slovenia and more unfavorable to Moldova and Fiji Islands.

For the last four years, the trend of the ratings in the Central and South-East Europe has been positive as a result of the fact that most of those countries improved the macroeconomic performances, materializing thus their efforts to restructure aiming the adhesion to the EU. There were only Ukraine, Moldova and Romania that recorded slower sudden changes for the better.

3. The evaluation of the external vulnerability

The existence of the systemic risks generates contradictory imperatives. On one hand, the desire of the financial institutions, both public and private, to avoid an international financial crisis results in the imperative of a more extended and more intense international regulation of the world finances system. Thus, subsequent to the East-South Asian crisis of 1997, the annual summit of the IMF/World Bank of 1998 generated an agreement concerning the international mechanisms of a more efficient survey and a larger transparency in issuing financial information, in the attempt to prevent such a crisis in the future.

On the other hand, submitting to more rigorous standards of regulation as comparatively with the potential competitors is not of the interest of any state or financial institution. The consequence is that the regulation instruments for the control of the systemic risks are often insufficient. In this respect, it is eloquent that there is no firm tentative to settle again the transfers of capital on short-term basis at international level, and that immediately after and irrespectively the East-Asian crisis. Taking into consideration the potentially volatile nature of the global financial markets and the instantaneous diffusion of the information between the main financial centers of the world, the systematic risks keep on remaining a threat for the functioning of the whole global financial system; no government alone can deal with this threat neither can it isolates the economy against this threat.

The increasing relevance of the systemic risk is strongly associated to the structural modification in the power balance between governments (and the international
agents) and the markets – more precisely, between the public authority and the private one from the global financial system. Although there is a tendency to exaggerate the power of the global financial markets, ignoring the central position of the state power in supporting their efficient operating, mainly in times of crisis, there are many convincing evidences to suggest that the financial contemporary globalization is a process propelled mainly by the market than by the state. Emphasized by the financial liberalization, the evolution towards private financial markets and institutions as “authoritative players” in the global financial system raises serious question marks as to the nature of the state power and the economic sovereignty. As pointed out by, „the states allowed the monetary private agents, organized through the intermediary of the markets, to dominate the decisions referring to who has access to credit (financing) and in which conditions. The international organizing of the credit has been transformed…from a quasi-public one in one almost entirely private”. In this new context, the autonomy and even the sovereignty of the advanced capitalist states become problematic in certain respects.

The lessons arising from the last decade crises consisted of the concentration of the IMF efforts on the surveillance of its members and the world economic context, by means of evaluating the external vulnerabilities at crises of the member countries. The vigilance and the capability to rapidly response to the crises and to their contagion constituted the new vectors of the IMF policies: the monetary policy must be conceived so that it is capable to administrate the tensions which may occur on the exchange rates; the fiscal reforms must be entirely enforced; the decisive moments for the implementation of the structural reforms must be not delayed.

The concern of the IMF has been guided mainly on securing the adequate reserves and the reserves management as well as on the identification of the general principles for the prudential management of the external debts. The IMF tries to achieve a system of indicators for the external vulnerability – talks are referring even to a revolution of the reserves policy (consisting of the evaluation of the vulnerability not only from the perspective of the foreign trade but also from the perspective of the needs of capital on short-term basis - the foreign debt service on short-term basis – for the application of certain systemic models for optimum alerting (EWS - Early Warning Systems) and, implicitly, of intervention through fiscal, monetary and currency policies. These actions are aiming to prevent the loss of the external liquidity and solvency of the member countries, with a negative impact on the credibility.

Of course, all of them are imposing the transparency increase of the macroeconomic policies of both the member countries and IMF.

References
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