

Global Economic Crises and the Effects on the Economic System

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Abstract

Crisis can be identified as certain micro and macro recessions that occur all of a sudden unexpectedly. The reasons behind the crises are reduction of a state's international reserves, fragility of the banking system, inflation, appreciation of local currency, foreign trade deficits, expansion of loans and the following increase in supply of money. The contagious nature of crises make them quite dangerous and threatening the world. With this perspective, global system forms one of the threats. In this study, while analyzing the dynamics of "global crises" starting from Great Depression of 1929 until today, an answer to the problematique on whether this new position of "global economic system" necessitates a new system perception or, actually, a warning mechanism that would prevent the fragility by revising the current system.

Key Words: Global Crises, Global Economic Systems

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1. Introduction

Crisis has turned into a concept which has a feature of increased incidence, as the world economy has become more global. Macro-economic imbalances, intense competition, financial deregulation, credit boom, poorly managed banks and lack of transparency have caused to banking crises.

Crises consist of different reasons. The major ones may be considered as: "Real Sector Crises", "Financial Crises", "Money (Currency or the Balance of Payments) Crisis", "Banking Crises", "External Debt Crises" and "Systematic Crisis".

2. Global Crises

Crises are very important for the future of the global economic system. With this aspect, the major economic crises in the world from the early 1900's to the present and their typology would be enlightening to know that subject.

Actually, each economic crisis with the different typology formed on changes in the global economic system. Even according to some major economists, arguments about crises with gradually increasing the frequency, forced us to a new perception of the economic system are known facts. It's useful to mention the great crises in the world before the effects of the crisis on the global economic system

2.1 1929 World Economic Crisis

The U.S. economy had high growth rates in the 1920s. While Fordist System was raising the production, increasing revenue growth due to production increased fees and therefore consumption accordingly increased. In real estate prices and even in the stock market greater gains were observed. Briefly, in economy all the ratios and the data seemed to be in order. Nevertheless, property prices made the balloon effect and after hurricane had been lived; house prices showed a serious decline in rates.

In early 1928 the Dow-Jones Index was 191, in September 1929 of it was 382. In 1928, while value of the shares bought with loan was 5 million dollars; in September 1929, it was 850 million dollars. In this situation, R.W. Babson made a statement as "The stock market crash is inevitable and the results can be very bad". After that the authorities gave assurances but investors did not heed these words of Babson (Erdağ, 2002; 76).

However, in October 21, 1929, on Monday, Foreign investors in the U.S began to sell their stocks and in October 24, 1929, on Thursday referred as "Black Thursday", Dow-Jones index fell by 25%. The ongoing days Stock prices fell nearly to zero, for this reason people's savings melted.

Although there were any pre-indicators of the crisis which started in the U.S., firstly crisis had appeared in financial markets and then affected the real sector. When we observe the causes of the crisis, the reasons includes; U.S.'s insists on the gold standard, unfair distribution of income, imbalance of foreign trade, companies' financial state of imbalance, giving excessive amounts of credits by banks and inexperience of bureaucrats who admin the economy (Can, 2003, 70).

The situation in Europe was as same as U.S. Some of the banks had economic difficulties in this reason both banks and companies went bankrupt. Correspondingly, a sudden drop has emerged in the total consumption and investments.

Between 1929 and 1933, GDP reduced by 1/3 (Aktan ve Şen, 2002; 5). As far as U.S.'s entered to the crisis, it caused to cutting of the loans. Hence Europe quite profoundly was affected by the situation. For instance, inflation increasing had shown per hour in Germany, 1/4 of workforce was unemployed.

2.2. The Oil Crisis (1974)

The USA's free emission because of Vietnam War and after losing confidence in the U.S. Dollar, "Bretton Woods" system collapsed. In addition, in October 6, 1973, as a result of tension between Syria and Israel, due to developed countries and U.S. had supported to Israel, oil-exporting Arab countries thereby reduced the production of oil by 5 million barrels in a day imposed an embargo on countries supporting Israel. Hereupon, price of a barrel of raw oil, was \$ 3 in 1972, reached to \$ 12 by increasing 4 times in 1974.

Meanwhile the greatest demand of Arab oil-exporting countries' funds required underdeveloped countries. However, due to economic conditions, these countries have begun not to cycle their debts. This created some supranational regulations, need for exchange of debt between countries and financial institutions in the world economy (Soyak ve Bahçekapılı, 1998, 5).

Process of recession has continued for 16 months until March 1975. In this period, the cumulative growth rate was - 3%. Oil shock affected countries which were dependent on oil in the world economy and importing of oil; and the world economy has entered stagflation. Accordingly, in the lots of countries, "moratorium" has been decelerated.

If the deep decline should be compared, after Bush government had took the ruling, it will be possible to say that it was slightly larger than the collapse of technology shares in the 2000-2003 period (Özhan, 2005, 34).

2.3. ERM Crisis

The countries in the crisis, there were low and stable inflation, increase in foreign exchange reserves and a budget surplus in general. The only problem was, raising interest rates and unemployment. The only reason of this was inadequate demand. Rising unemployment due to insufficient demand, only be resolved by expansionary monetary policies. Governments had to implement a hard monetary policy by reason of the fact but that expansionary monetary policy would lead to problems when it was implemented on fixed rate. This has led to stagnation in European countries.

ERM Crisis, while economic aggregates are running a normal course, a new type of crisis is caused by the negative expectations. EU member states participating in the European Monetary System, indexed their money to ECU over a fixed exchange rate. Speculative attacks have a major role in the European Monetary System. However much foreign exchange reserves in a country, it can not be as much as experiencing capital flows and thus capital flows may be leading to speculative attacks. Crisis in financial markets couldn't be guessed so they may be exposed speculative attacks.

After speculative attacks on Finland and Sweden had succeeded, Italian lira couldn't prevent and it devaluated of 7%. So the attention of speculators attracted to England. As a result of attacks against the British Pound, in September 16 1992 despite intensive interventions of Bank of England, interest rates in Britain rose by 5% in one day (Akdiş, 2000; 60). While some coins were faced with the devaluation, England and Italy was forced to leave the ERM and In August 1993 the ERM fluctuation limits increased from 2.25% to 15%.

According to Krugman, ERM countries, which was the case of to keep currency stable, couldn't follow expansionary policies and unemployment was shaped by the result of insufficient demand, have been the main trigger for the crisis (Erkekoğlu ve Bilgili, 2005:24).

The crisis starting with the British Pound and that deeply affected to the ERM system have 4 features. These are: a) Speculation plays a major role in crises. b) In a world where capital flows are high foreign exchange reserves not a function of preventing the crisis. c) Crisis occurs unexpectedly. d) Affected by the crisis and the countries currencies out of the band with the measures taken, brought their economies to a better position, with regard to countries trying to keep their money in the band with coercive measures (Akdiş, 2000:61).

2.4. South East Asian Crisis

High-performing Asian economies were showed unique growth rates with human and physical capital between the years of 1960-1989. In this period, Asian economies had more factor productivity than 70% of developed countries.

Of these; Japan, Korea, Hong Kong, Malaysia, Taiwan and China had the highest rates of total factor productivity in the world (World Bank, 1998:259). In Asian countries, there was; justice in income distribution, political stability, decreasing consumption and increasing savings, a growth model based on exports and technology transfer. In brief, was mentioning a complete miracle of Asia.

In Southeast Asia, the crisis described by especially ineffective distributed investments. On the other hand, signals the emergence of the crisis was formed by significantly shown current account deficit increasing figures. In Thailand while current account deficit was 5% of GDP in 1993, this rate increased to 8% in 1996. Similarly, the rate of Malaysia's current account deficit rose to 5% in 1996 (Kayacan, 1998:4).

The growing current account deficits in Asian countries, wrong investments and non-refund of loan debts, investments shift in the field of real estate and not providing returns in the short term, short-term nature of entering capital and carrying speculative attacks, China's devaluation in 1994 and loss of competitiveness of other Asian countries, sharp increases in real estate prices, fragility of the financial system, bankers' inexperience, the balloon effect in economy, lack of transparency and panic were the main causes of the Asian crisis.

Observed in the first half of 1997, bankruptcies, students' rebellions and fall of governments did not exodus of foreign capital. But, on 2 July 1997 with the devaluation of Thailand Baht, the Asian crisis erupted. The crisis quickly spread to other Asian countries. With consideration of one-fourth of the world exports was performed by Southeast Asian countries, it is exceptionally ordinary that the Asian crisis affects with jumping to other countries including Asian countries particularly.

The main reason for the crisis according to Krugman is, resources trending to non-commercial areas from commercial areas in the short term. Also Hedge funds presence in Southeast Asia is the main cause of the crisis.

2.5. Mortgage Crisis

Mortgage system is, applied since many years in the U.S. and with terms extending up to 20 - 30 years providing home ownership opportunities for a home loan system. According to this system, people who want to buy a house can receive loans from credit institutions with fixed or variable interest rates. These credits were Prime Mortgage and Subprime Mortgage. Receivers of these credits even if can't pay the loan; by selling their homes they would be able to achieve substantial gains. Organizations which provide these loans will pass loans on the market. Investors are also buying them. Because risky loans will bring more interest rate to buy them provides more returns.

The sum of mortgage market was \$ 10 trillion. 14% of the mortgage market, 1.4 trillion dollar part consists of subprime loans. Ratio of the troubled loans is 20% and in 2005 - 2006 this figure was 25% of subprime loans.

Credit crisis, began with Subprime mortgage loans, extended and affected other types of credits caused to the entire mortgage market has totally affected. Balloon increases in housing prices have caused asymmetric information in the market, has led to incorrect directing of credit users and has caused the perception of house purchase as an investment instrument (Demir, Ermişoğlu, Karabıyık and Küçük, 2008:4).

When we look at the causes of the mortgage crisis; corruption the structure of mortgage loans and problems in refund, increasing interest rates to prevent inflation and thus increasing the number of people failed to pay credits, overvaluation of the housing sector and with the rise of short-term dollar interest rates has become a balloon in the housing sector prices falling and the bubble's burst, to reduce the risk of subprime mortgage loans tightness in the securitization and due to the problems in these loans bond values fall thoroughly, funds have the feature of Hedge funds and the expansion of the credit derivative markets, credit rating agencies lowering bond values of mortgage loans because of unpaid loans, may be considered.

Mortgage crisis is, even though there is no deterioration in the macro-economic policies, the balloon consisting in the financial system, fluctuations in real estate prices and because short spread of the crisis to all world countries complies with the 3rd generation of the crisis theories. However, spillover effect has never been so effective in any crisis. For this reason even if comply with 3rd generation of the crisis theories, can't explained exactly with 3rd generation of the crisis theories. Mortgage crisis is a crisis, emerging in financial markets and quickly spread to the real sector.

3. Effects of Crises on the Global Economic System

The world economic crisis of 1929, has prepared the end of view of Classical Economics and Keynesian policies have been dominated the economy. The economy was dominated by the principle of social state. Separation of duties was made in the banking system. By bringing deposit insurance system small savings depositors was protected, public took along the power of syndicates with them against unemployment. In addition, The IMF was established in March 1946. By fixing 1 ounce of gold to 35 dollars the gold standard was abandoned.

The main reason for the crisis of 1974 was the increase of the prices and this crisis was an oil crisis. For this reason "Petro-currency" called significant funds consisting in the hands of the member countries of OPEC were offered in order to assess in many developed financial markets especially in Europe. Here is the new task of the IMF and World Bank begins. A country who wants to debt in international financial markets will pass auditing of the IMF and to the country receiving its approval countries and international banks will give debt with peace of mind. By this way it is possible to say that goes the revision of a system in this crisis.

ERM crisis, unexplainable crisis with canonical models and reveals the importance of second-generation crisis models. Unpredictable ERM Crisis affected all EU countries with the effect of infection. The feature of a new type of crisis shows another gap of the "system".

Crisis in Asia, in particular highlighted by Krugman, drawn attention to "Crony Capitalism" and heavy losses in Indonesia was described with that. Like years of Japan's bubble economy there was also a moral hazard problem for Southeast Asia; this problem is a problem, called shortly after the crony capitalism. Actually owner of a finance company mostly relatives of a government official (Krugman, 2005:94). As can be seen from here, the logic described as "crony capitalism" not just a local corruption also can be global effects.

In addition, the crisis in Asia have caused the private capital investments escape from the area, the banking sector has seen major impact. The Asian crisis spread to the whole region with domino effect quickly. This is the most important difference between the crises in Mexico.

Asian crisis is a financial crisis in a general meaning. In most Asian countries were caught in the crisis, external debt has been largely provided by non-bank private sector. Asian crisis is a financial crisis, contagion effect was observed in Asian crisis. Is a crisis, the second generation of theories remained invalid, and the third-generation theories occurred.

Mortgage crisis, for the predictability seems to fit the first-generation crisis theories. However, although closer to Krugman's theory of third-generation crisis, because of affects all the world's economies extremely severe may be expressed with a new crisis theory by accordance. This "crisis" might produce the extremely severe effects, A. Greenspan also wrote in 1980 "The Great Malaise" in his essay, was indicate that speculative attacks Might produce serious problems in the U.S. housing market.

Conclusion

Crises are the most important issues for both developing countries and developed countries. The most important feature of the crisis is showing an effect of infectious and contagious by time.

Analyzed in terms of the crisis theories, first-generation crisis model is a predictable crisis. Defends a fixed exchange rate system never should not apply. Second-generation models are defending the crisis can not be predictable, governments play a more active role, but after a certain period gave up fixed exchange rates advocate implementing a flexible exchange rate system model. Sometimes in countries, did not show any macro-economic corruption and while there is no risk of crisis could face with the crisis. Krugman connected it to “crony capitalism” and has revealed to theory of the third generation crisis.

1929 Economic Crisis while ending the concept of classical economics evaluate the system to Keynesian economic approach, this situation changed after the 1974 Crisis and monetarist economic policies started to be implemented. Moreover, not only in economic and monetary systems, changes in the approaches have emerged. Then the monetary system for 100% gold (Bretton Woods) indexed to the U.S. dollar and in the 70’s this situation had been changed, countries created their monetary policies independent from the gold. Strong currencies traits of being convertible in international trade, as result money regions have occurred.

Global system maintained the structure with some interventions, new supra-national institutions and approaches to today. However, like the expression of many scientists rather than revised the system also a new system could be born.

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