The 1997- 2011 Global Financial Crisis:
Causes, Policy recommendations and Lessons

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Abstract

This report will highlight the financial and economic crisis from 1997 to 2011 that started of South East Asia then migrated to Russia, Turkey, Brazil, then migrated to US and finally landed in Europe. The report will explore what were the factors for the economy and financial crises and why lessons were not learnt from this enormous crisis. The report will also summarise the policy measures that the International Financial Institutions (IFIs), such as the International Monitory Fund (IMF), has provided to tackle the crisis. Some of the influences and policy suggestions made to try to avoid future crises are also covered.

During economic boom in US and Europe the financial sector expanded and become unmanageable to control. The fast growing become very difficult to control by central bank such as Bank of England and Federal Reserve in US and the risk builds up and leads to global financial crisis.

**Keywords:** Global Financial Crisis, IMF, OECD

**List of Abbreviations**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>IFI</td>
<td>International Financial Institutions</td>
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<td>IMF</td>
<td>International Monitory Fund</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>LTCM</td>
<td>Long Term Capital Management</td>
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Introduction

The first financial crisis started in the 1930’s Great Depression in the United States when the Stock Exchange collapsed and hundreds of banks closed down, also the value of currency declined sharply but the world economy and financial market found a solution quickly to tackling the crisis before it spread further. Then after World War II, the financial market was not in a great position. Some 42 countries established the International Monetary Fund (IMF) that was created at Bretton Wood Conference and it came into existence in 1945. The purpose of the Bretton Wood agreement, which was signed by 29 countries, was to convert dollars to gold; and it came to an end in 1973 when the United States refused to convert dollars to gold. Then from 1973 to 1996 the economy and financial market was very stable with the economy growing sharply, especially among developed countries.

Once again the financial crisis came to light, not in US or Europe but in Thailand, when fixed exchange linked to the US dollar collapsed. Subsequently the crisis spread to neighbouring countries such as Indonesia and North Korea. The aim of this report is to investigate how the financial crisis began that started in 1997 in Thailand, then spread to all of South East Asia before migrating to North Asia and then to major Emerging Markets around world throughout 1998. What caused it and why have lessons not been learnt since then? This report will explore a number of policy recommendations that were provided by financial institutions including the World Bank (WB) and IMF.

How 1997 financial crisis started?

The 1997 financial crisis started in Thailand. The main cause of Thailand’s financial chaos lay in extreme borrowing by the private sector, multiplied by careless regulatory failure by the central bank. The high capital mobility, exchange rate, property boom and over valuation of share prices were all unsustainable. Between 1995 and 1997 the world witnessed Thailand’s economic growth that was not based on growing outputs, but was based almost completely on borrowed foreign capital, as well as on excessive private debt.

The main problem for Tigers countries was relying on foreign investment heavily. Many of large investors in the US went to Tiger countries investing in the property market because the return was very high, and the market was doing well in limitation of inflation, as shown in table 1 below.
According to Punyaratrabandhu (1998 Asian survey), the total of external debt was about 70% private and only 30% public debt, making it more difficult for Thailand’s government to recover because investors lost confidence and they pulled out from Thailand, looking to invest elsewhere.

Table 1: Key Variables in 1996: The Asian Tigers before the Crisis

<table>
<thead>
<tr>
<th>Country</th>
<th>Investment as a Proportion of GDP (%)</th>
<th>Gross Savings Rate of GDP (%)</th>
<th>Trade as a Proportion of GDP (%)</th>
<th>Share of World GDP (%)</th>
<th>Real GDP Growth (%)</th>
<th>Consumer Inflation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>31.3%</td>
<td>30.6%</td>
<td>122.9%</td>
<td>0.6%</td>
<td>4.9%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>32.1%</td>
<td>31.2%</td>
<td>20.4%</td>
<td>0.8%</td>
<td>8.0%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>42.2%</td>
<td>42.6%</td>
<td>78.9%</td>
<td>0.4%</td>
<td>8.6%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Philippines</td>
<td>23.2%</td>
<td>15.6%</td>
<td>31.2%</td>
<td>0.3%</td>
<td>5.7%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Singapore</td>
<td>36.5%</td>
<td>50.1%</td>
<td>...</td>
<td>0.3%</td>
<td>6.9%</td>
<td>1.4%</td>
</tr>
<tr>
<td>South Korea</td>
<td>36.8%</td>
<td>35.2%</td>
<td>28.9%</td>
<td>1.8%</td>
<td>7.1%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>21.2%</td>
<td>25.1%</td>
<td>40.1%</td>
<td>1.0%</td>
<td>5.7%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Thailand</td>
<td>42.2%</td>
<td>35.9%</td>
<td>34.9%</td>
<td>0.7%</td>
<td>5.5%</td>
<td>5.8%</td>
</tr>
</tbody>
</table>


When investors found out that the ratio of Thai Baht of loans to Gross Domestic Product (GDP) in Thailand was almost 140%, investors started panicking. This spread to other countries for instance the Philippines, Indonesia and Malaysia, whose financial markets all fell in the months following the July 1997 Baht devaluation (Figure 1); the reasons being that those countries were in the same trade market.

The contagion reached North Korea in a matter of six months. Investors left the market and looked to invest in Russia because the Russian economy was thought to be strong and not based on government bonds and debts. Investors thought Russia would not collapse, as South East Asia did, as Russia was a powerful country and if Russia was in financial crisis then other rich nations would bail it out. The suggestion was wrong and it was based on incorrect interpretation, and Russia’s financial market collapsed.
In a matter of no time the Russian Rouble collapsed (Figure 2) and in early December 1998 Russia started printing out money to pay state workers and pensioners.

With the beginning of 1999 the crisis reached Brazil. Pilbeam (2006) said the Russian crisis had a direct impact on the Brazilian market due to having a huge public-sector deficit together with a large external debt. However Brazil did have enormous assets in US Dollars. The Brazilian government had been under intensive pressure with the stock market and exchange rate collapsing (Figure 3) and so the government
arranged to accept an IMF loan of $40 billion in December 1998. The purpose of the emergency loan was to bring back confidence to investors and this was successful, as can be seen from the Figure 3, and the market slowly started to recover.

The contagion spread to US markets and financial analysts noted that if the financial crisis started from developed countries how was the US market going to survive? The first storm hit Long Term Capital Management that directly controlled billions of dollars of assets and indirectly controlled trillions of dollars. The LTCM type of hedge fund involving currency dealings and was thought too large to fail. By September 1998 LTCM lost control and the contagion arrived on Wall Street, which collapsed as a result of this one single fund and from this dangers spread all over the global financial world.

It was impossible for public money to be able to afford to bail out the LTCM. The Federal Reserve went to the banking system because only the banks could rescue the LTCM and they asked Goldman Sachs Bank to bail out the LTCM. Then financial crisis actually started when the banks became involved and took control of the financial crisis because banks always work in favour of share holders and not to serve the public.

Wolf (2009) in his television interview with WN Network said the financial crisis contagion reached the US based on property bubbles because investors invested heavily in the property market, and many people in the US borrowed money on low interest rates to buy property; and when the banking system began running out of cash then crisis started.
The contagion moved from the USA to Turkey in 2001, Moffett, Stonehill and Eiteman (2003, p. 113) says: “Turkish banks borrowed billions dollars at lower rates, converted them to lira and bought high-yielding Turkish Government Treasury bills”.

The value of the Lira had been controlled by the Turkish government due to comparatively high interest rates during the period 1998 and 1999. The government followed Brazil and they devaluated the Lira but not as much of what inflation discrepancy called for. Then the Turkish government asked the IMF for a loan and the IMF provided a $ 7.5 billion loan to bring stability to the market and save their banking system (figure 4).

Then in 1991 Argentina commenced a currency board arrangement that pegged the Peso to the US dollar, at that stage the Peso was linked to the US dollar’s movements against other currencies. This enabled strong growth of the economy and helped to reduce the inflation rate from 100% in 1991 to almost 1% in 1996 (Pilbeam, 2006). The financial crisis affected Argentina in two ways. Firstly the strength of the US dollar during 1999 to 2001 resulted in Argentina facing falls in real GDP of 3.4% in 1999 to 4.4% in 2001 (Pilbeam, 2006). Secondly the Brazilian devaluation damaged the Argentine economy because Argentina was a close partner with Brazil in terms of exports.

In 2001 Argentina increased interest rates to stabilise the value of the Peso, and the government also agreed to accept a loan package of $14 billion from the IMF, but there was still no signs of any recovery (Figure 5). This was because the Argentina crisis had been partly created by foreign direct investors and banks who reduced their

![Figure 4 - USD/Lira](source: Historical Exchange Rates OANDA)
exposure to the country, but mainly because domestic banks made large losses due to mismatching between their dollar liabilities and dollar assets (Pilbeam, 2006).

Despite the $14 billion loan from the IMF, in 2001 Argentina still failed to reduce its fiscal deficit and this created more pressure on the Peso. Then in July 2002 Argentina received another loan package of $30 billion, but still there was no sign of recovery and Argentina’s government accepted the IMF recommendations by reducing government spending and increasing its interest rate. By this time Argentina’s government realised the IMF recommendations were not working and were resulting in increased unemployment, reduced capital inputs and increasing poverty due to the government stopping subsides to local farmers. The Argentine government responded by demolishing the IMF impositions and the economy started to slowly recover in 2003.

Desomsak et al. (2009) noted that the financial crisis had many important effects, largely in the tiger economies such as Thailand and Malaysia. In general the crisis created the higher debt levels for local firms and it became a major problem for the countries to stabilise their markets, making it more difficult to recover quickly. There were no growth opportunities in markets or in share price performance. Productivity also changed considerably after the crisis in the country’s most affected.

**The Financial Liberalisation**

The main reason for the 1997 Asian financial crisis was a failure and lack of systematic banking and regulation in the Tiger countries. Countries with fragile
financial systems were not taking advantage of liberalisation. Economic models say that financial liberalisation can generate economic growth through investments, savings and productivity of capital.

Hakura (2005) argued healthy and powerful financial sector management can facilitate banks and other financial market members to achieve improved identification of price risks, thus minimising currency and maturity mismatches that alleviates the “fear of floating.” Likewise, stable market growth will assist improved long-term funding and consequently diminish maturity mismatches. Vital for the central bank is the need to stabilise the currency market and price so it can win public confidence that it can control inflation.

Ghosh (2005) noted financial liberalisation is more beneficial for developed countries especially through saving, for example personal saving such as pension funds for retirement. All this means increasing the demand for more diversity in forms of saving on higher returns. Then the saving can be lent on higher interest rate and invested to generate more inputs. The financial sectors become more attractive and expand in developed countries as well as boosting the economy.

Theory of financial liberalisation

When having a strong financial sector, measured liberalisation always creates growth and improved GDP (IMF 2001 annual report). However if the financial sector regulation is fragile then it may impose greater financial controls. According to Hakura (2005) the theory of financial liberalisation is based on the following:

*Domestic Financial liberalisation* that is about reducing institutional power over controls of interest rate, allowing the central bank to operate freely without government intervention. Governments should create an environment for banks to develop such as through privatisation and encouraging competition among banks to attract depositor and borrower. Also allowing banks to do risky and costly projects, but being responsible for any failure. As you can see from (Figure 6), the countries with a financial crisis and with weaker financial sectors struggle to make any voluntarily transition from pegs to intermediate.

*External financial liberalisation* normally coincides with changes in the government control of exchange rates and allows the financial sector to trade freely and also allows foreign investors to trade with different exchange rates. Vlachos and Waldenstrom (2005) state that countries with more independence in terms of financial liberalisation are growing faster compared to developing countries (Table 2). Ghosh (2005) suggested external financial liberalisation is based on measures to let foreigners
hold domestic financial assets, as well as allowing internal firms to hold foreign financial assets and allowing foreign currency assets to be freely traded in the country.

**Failure of financial liberalisation**

GU and Dong (2011) suggested that there is a strong correlation between growth and instability under conditions of capital inflow if there is no enhancement to financial regulation. This may create high risk opportunities for the economy and Foreign Direct Investment (FDI). This is because many investors prefer to take high risks with high returns, but with the potential for higher risk of crises due to its larger exposure to attacks and external impacts. Ghosh (2005) noted that supporting financial sector liberalisation means you are allowing lack of transparency, dishonesty and unfettered capitalism. Financial liberalisation actually is a waste of capital resources. Financial liberalisation has been created by the United States and Japan, and their policy is not...
working in other countries such as the Tiger economies where the IMF blames Asian countries for the financial crisis because they did not follow IMF recommendations.

Table 2: Countries with more independence in terms of financial liberalisation are growing faster compared to developing countries

<table>
<thead>
<tr>
<th>IMF de facto Classification</th>
<th>Updated Rasthur-Zagoiff Classification</th>
<th>Monetary Framework</th>
<th>Financial Policy Frameworks 2/</th>
<th>Financial Liberalisation 3/</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Inflation Targeting 1/</td>
<td>Bank Supervision</td>
<td>Securities Market</td>
</tr>
<tr>
<td>Peg</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China 3/</td>
<td>Peg</td>
<td>No</td>
<td>1</td>
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<tr>
<td>Jordan 3/</td>
<td>Peg</td>
<td>No</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Peg</td>
<td>No</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Morocco</td>
<td>Intermediate</td>
<td>No</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Peg</td>
<td>No</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Hungary 3/</td>
<td>Intermediate</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Israel</td>
<td>Intermediate</td>
<td>Yes</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Argentina</td>
<td>Intermediate</td>
<td>No</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Czech Republic 3/</td>
<td>Freely Floating</td>
<td>Yes</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Egypt</td>
<td>Intermediate</td>
<td>No</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>India</td>
<td>Intermediate</td>
<td>No</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Freely Floating</td>
<td>No</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Intermediate</td>
<td>No</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Russia 3/</td>
<td>Intermediate</td>
<td>No</td>
<td>2</td>
<td>1</td>
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<tr>
<td>Thailand</td>
<td>Freely Floating</td>
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<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Brazil</td>
<td>Freely Floating</td>
<td>Yes</td>
<td>1</td>
<td>3</td>
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<tr>
<td>Chile</td>
<td>Freely Floating</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Columbia</td>
<td>Intermediate</td>
<td>Yes</td>
<td>2</td>
<td>3</td>
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<tr>
<td>Korea</td>
<td>Freely Floating</td>
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<tr>
<td>Mexico</td>
<td>Intermediate</td>
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<td>3</td>
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<tr>
<td>Peru</td>
<td>Intermediate</td>
<td>Yes</td>
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<td>Philippines</td>
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<td>2</td>
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<tr>
<td>Poland 3/</td>
<td>Intermediate</td>
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<td>3</td>
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<tr>
<td>South Africa</td>
<td>Freely Floating</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Turkey</td>
<td>Freely Floating</td>
<td>No</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

When the IMF recommended those countries that had financial crisis to deregulate their financial systems, and they followed the IMF recommendations, this then led to huge FDI which in turn caused the currency depreciation, for example Argentina. Ghosh (2005) said another failure of financial liberalisation is that it
encourages the financial sector to increase the supply of money, pushing inflation to high levels and reducing output growth. Even the IMF are almost sure that financial liberalisation has a little role in attracting investment to developing countries.

**Washington Consensus**

The Washington Consensus came out when the financial crisis hit Latin America and the rest of the world encouraged it to adopt liberalisation and privatisation. The Washington Consensus was considered by John Williamson in 1989, an economist from the Institute for International Economics. His view was based on ten broad points which he shared amongst the other institutions including the IMF and the World Bank.

The Washington Consensus was approved by developed countries and they persuaded developing countries to follow the recommendations in order to improve the financial and economic conditions.

**Recommendation of Washington Consensus**

1. **Fiscal Discipline.** Relates to the control of government deficit and monetary balance of payment, and the only way to reduce government deficit is to reduce public jobs.

2. **Public expenditure priorities.** This point is about reducing subsidies and increasing spending on health care and education.

3. **Tax reform.** The purpose of a tax system should be based on a broad and moderate tax rate.

4. **Liberalisation interest rate.** Countries should decide how to control interest rate and balance it with real GDP. For example if the US or UK act quickly to reduce interest rates early, then they may be in a better situation.

5. **Exchange rate.** The aim was that developing countries make their exchange rate more competitive and make their exports cheaper. For example China are keeping RMB as low as possible to ensure their exports are attractive to foreign markets.

6. **Trade liberalisation.** This is about openness, reducing barriers to entry and becoming global, and by doing this it allows the growth of the economy and transparency.

7. **Foreign direct investment.** Allow foreigners to hold domestic assets and allow domestic firms to hold foreign assets.
8. **Privatisation.** Allow the public sector to become privatised as this can improve economic growth. For example the UK was not as rich in the 1980’s as it is now, there were not as many cars on the street as now. Then Lady Margaret Thatcher’s regime privatised most of the British public sector including British Telecom, British Gas, Railways etc and this has improved the British Economy since then.

9. **Deregulation.** Focused on careless counties, improve government regulation such as improving corruption, discrimination among industries and being part of international trade.

10. **Property right.** This is mostly related to foreign direct investment and ensures their assets are safe plus reduces government intervention.

**Failure of Washington Consensus**

In the McKinnon and Shaw models, they state that savings take place before investment. However savings cannot finance capital accumulation. Arestis (2004) said in reality there is evidence in the past 15 years that shows that the 10 recommendations of the Washington Consensus have proved to be a disaster for developing countries. This is due to it being created by developed countries and simply it does not work for developing countries.

Cable (2009) noted that the Washington Consensus recommendations such as deregulations and privatisation were an enormous disaster for financial markets. By accepting the Washington Consensus serious failures of the markets were generated, especially in Asian markets, and also let down many developing countries including Argentina. During the 2009 G20 summit in London, a former British Prime Minster declared the Washington Consensus to be dead. This was due to the strong intervention undertaken by governments in response to market failure.

**The role of institutions during and after crisis**

When the 1997 crisis occurred, the most influential financial institutions in the world such as the IMF and WB, came up with different strategies. Let us concentrate on the IMF strategy for the 1997 crisis. The IMF (2000) said they had been called in to offer financial support for three of the countries generally and critically affected by the crisis: Indonesia, Korea and Thailand. The scheme focused on three important key elements
Financing. The IMF set up plans to lend billions of dollars for the correction and improvement of government regulation and the banking system, and to stop private capital outflows.

Macroeconomic policies. The aims were to help manage exchange rates and prevent currency depreciations, reduce inflation, stabilise interest rates, increase confidence, increase capital inputs and improve fiscal policy; including reduced deficits plus control of government debts as well as improved balance of payments.

Structural reforms. One of the IMF conditions was to improve and the deregulation of financial corporate sectors. Pilbeam (2006, p. 476) said

“The IMF policy determined on closing down the banks with the highest proportion of non performing loans”.

Failure of Institutions to tackle Financial and Economic crisis since 1997

The institutions’ fiscal and monetary policies came under vast critical pressure. Stiglitz (2002) argued that the IMF’s tough fiscal discipline, including high interest rates and closing down banks, drove countries’ economies into depression and made the situation worse. During the Asian crisis most of the countries were running a budget surplus or small deficits. Pilbeam (2006) said IMF programmes and loans actually acted as an invitation for possible infection and corruption, most of the loan packages went to government rather than creating opportunities for local industries to create jobs.

Another major failure of the IMF and WB was that they were following Washington Consensus. However the Washington Consensus was long dead according to several economists and politicians, including former UK Prime Minster Gordon Brown. Most of the IMF and WB decisions were made behind close doors as they are a very secretive institution. Furthermore they are run by developed countries such as the US. There is also evidence that they are out of date, for example their policy does not cover the bail-out, contagion and moral hazard, cronyism, capitalism and globalisation. Demonstrably their policies are out of date and their guidance requires amending.

Wood (2006) stated there is no unquestionable proof that the IMF and WB know what is good for their borrowing countries as their calculations are based up on theory rather than practice. They deliver their policy with an eye of a politician. Both institutions base their lending on out of date conditions. They impose what can be described as a virus of liberalisation, deregulation and taxation.
IMF and 7 pillars

Owen (2011), as Deputy Director of the IMF’s Middle East and Central Asia Department, came up with 7 pillars to strengthen the international financial system. The aims of the Seven Pillars of Prosperity - Diversifying Economic Growth in the Caucasus and Central Asia, are as follows (Owen, 2011):

- Reduce the role of the state;
- Greater openness to new domestic and foreign firms;
- Develop a more competitive and effective banking sector;
- Strengthen governance and the quality of institutions;
- Other improvements to the business environment - like reducing the cost of procedures for trade;
- Improve transport and telecommunications infrastructure; and,
- Improve regional trade and investment links.

Why were lessons not learnt from the Asian financial crisis of 1997?

Powerful countries like US, UK, Japan Europe and China are major causes behind this massive default where once more unnecessary government spending, as well as other external shocks that occurred in the 1990s (such as the Mexican peso collapse of 1994, the East Asian crisis of 1997, as well as the Russian default of 1998) shocked the Argentine economy. These countries financial crises make it more difficult to prevent and bring the crisis under control.

Investigating the above crises, there are a number of conclusions one can make. First, countries need to be careful and seriously look at fiscal policy that control government spending and get public debt under control. For example the little plastic cards which are called credit cards, were the biggest dangers for the 2008-2011 global financial crisis. In the US most household have a credit card and the purpose of having a credit card is to borrow as much as you can.

The US became the biggest debtor in the world borrowing from Japan, China and Saudi Arabia and they invested in non worthwhile projects, for example the property market in California which collapsed. Instead of borrowing money and investing in the property market they should have invested in capital projects such as technology, improve local education and health care.
White (2007) noted that the US and UK offer expenditure insurance through bankruptcy law, moreover advising and encouraging individuals to become self-employed or set up their own businesses. If their businesses fail there are no costs and punishment and they may be able to keep their home. Globalisation and capitalism make the financial and economic crises more difficult. For example Greece’s financial crisis had a huge impact on all Euro zone, a small nation of countries with a population of 12 million, which had a major cause on the rest of the World financial market. IMF and Europe’s powerful economies such as Germany and France pushed Greece to the edge of poverty with high unemployment rates compared to other countries in the Euro Zone.

Pilbeam (2006) states that the government bailout is one of the financial crisis models and it creates ‘moral hazard’. This allows financial intermediaries in the country to borrow money at relatively low interest rates of interest and then lending it out to very high risk investors. For example the major cause of the 2008 – 2011 crisis was government bailout guarantees such as the Federal Reserve in USA and the Bank of England. Moral hazard was created when the governments started bailing out collapsed banks such as Fannie Mae / Freddie Mac in USA bailed out by the Federal Reserve; then Northern Rock bank collapsed in 2008 and was rescued by the Bank of England on behalf of British tax payers.


Ferguson in his TV interview with NW Network argued that China plays a major role in creating this current financial crisis. China’s cheap labour and product push inflation to high level in US. China hugely relies on their exports to US, while China’s intervention on foreign currency markets keeps its currency weak and makes their products cheap and attractive. In a reversal of the capital flow, China then finances the US deficit account. Ferguson noted the success of Chaind (China + India) makes it impossible to tackle the world crisis because they control half of the world food according to World Bank 2009 annual report and they are pushing the price of foods to high levels.

The cause of 2008-2011 global financial crises

Swedberg (2010) said that the 2008 global financial crisis started in the US, when the housing market bubble went bust and the balance of payments went to deficit, plus the level of inputs reduced and government debt sharply rose. Subsequently the Federal Reserve started reducing interest rates and printing money, then the inflation rate rose. Reducing interest rates had huge impacts on EU exports.
The key factors for the 2008 US deficit are based on consumers spending less and saving more, creating a deficit in revenue. Then in 2008 Ireland’s banks failed, GDP slumped, unemployment rose and the country needed a bail out. By 2009 Greece became bankrupt and needed emergency loans followed by Portugal and subsequently Europe fell into crisis.

The biggest bail out was more than €300 billion for Greece. If the European Bank was not able to bail out Greece then they might have been forced to leave the Euro currency. The consequence would have been that world trade would have suffered, because 50% of the world shipping trade take place in Greece.

**Early warning System**

The purpose of an Early Warning System (EWS) is to avoid any financial and economic crisis in future. There are many ways it can be used to calculate a crisis, for example over valuation of a currency e.g. Australian dollar over valued (Figure 7).

Kaminsky *et al* (1998) state that early crises can be predicted based up on the performance of international raw materials, the real exchange rate, household debt, government debt and level of inflation. Other signals include money growth, real GDP plus export performance.

<table>
<thead>
<tr>
<th>Crisis (Within 24 months)</th>
<th>No crisis (Within 24 months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Signal was issued</td>
<td>A</td>
</tr>
<tr>
<td>No signal was issued</td>
<td>C</td>
</tr>
</tbody>
</table>

A = Number of months indicator good signal.

B = Number of months indicator bad signal.

C = Number of months indicator failed to issue a signal (which would have been a good signal).

D = Number of months in which the indicator refrained from issuing a signal (which would have been a bad signal).

A perfect indicator would only produce observations that belong to the north-west and south-east cells of this matrix. It would issue a signal in every month that is to be followed by a crisis (within the next 24 months), so that A (greater than) 0 and C = 0, and it would refrain from issuing a signal in every month that is not to be followed by a crisis (within the next 24 months), so that B = 0 and D (greater than) 0.

Another signal of crisis such as conflict e.g. during the Libya war had an impact on oil prices (Figure 8).

Power Purchase Parity, usually mismatching of currency, is due to over valuation of the currency and exchange rate exposure. In addition the signals of EWS can be found from various indexes such as the Baltic Dry Index (if trade is high then the cost of transfer freight or vestal will be high).

BBC (2011) said The Organisation for Economic Co-operation and Development (OECD) has been notified that the Euro Zone and UK might be entering a recession in 2012, which indicates their prediction was correct. This is due to Eurozone non-payment by Italy and Spain and it might impact on global economic growth. Table 3 forecasts indicate reduction of growth in 2011.
EWS can indicate crisis from political risk e.g. during the current Spain election the Spanish market crashed (Figure 9).
Table 3: Forecasts indicating reduction of growth

<table>
<thead>
<tr>
<th>OECD growth forecasts</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>1.7%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Japan</td>
<td>-0.3%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Germany</td>
<td>3.0%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Britain</td>
<td>0.9%</td>
<td>0.5%</td>
</tr>
<tr>
<td>France</td>
<td>1.6%</td>
<td>0.3%</td>
</tr>
<tr>
<td>Italy</td>
<td>0.7%</td>
<td>-0.5%</td>
</tr>
<tr>
<td>Spain</td>
<td>0.7%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

Source: BBC.com

Bloomberg also indicates any signs of a crisis by providing details such as market prices, and also delivers financial news and information including real-time and historic price data, financials data and trading news. Mello and Padoan (2010) argued that the global imbalance increased rapidly in the mid 1980s after the then second oil price increase between the Plaza and Louvre agreements on exchange rate management.

Imbalances started to go up again slowly in the second half of the 1990s, an upward trend that came to an end with the global crisis in 2008. Then the US account became deficit and China, Germany and Gulf countries became very healthy and developed surpluses (Figure 10).

**Recommendations to prevent current and future crisis**

Government should be monitoring own spending as well as ensuring that spending is based on long-term projects that improve the country’s economic growth. Government should restore certainty amongst investors and demand consistency, and swift actions should be taken if required from governments and central banks. Government must stop printing money and stop borrowing from central bank to cover own expenses, which has a negative impact by pushing inflation to high levels and depreciation of the currency. For example since the Bank of England started printing money, the Sterling pound GBP has devalued against the AUS dollar (Figure 11).
Figure 10: Account balances of US, Japan, Germany & China
Sources from OECD

More importantly, Governments must stop throwing away taxpayers’ money on unnecessary projects. Ferguson in his TV interview with NW Network said that the world can escape from the current crisis by breaking into Asian savings such as those held in China and India, and some of the Tiger countries including Supper Market (Singapore) and asking them to contribute to curb the current financial crisis.

The Euro Zone has already asked China to contribute to the European Bank but is the Chinese government willing to lend money to Europe and willing to write off 50% of their credit?
Nationalisation will be part of the current global crisis and it is the best solution. Also bank boards are very important for investors and part of the financial world. Financial sectors are just as important as agriculture, and furthermore it is important to look at the history of past financial crises and to learn from them. The World can escape from the current financial crisis by establishing democracy states and making people own property. The European Commission (EC) President Barroso (BBC 2011), believed that the EU should request a complete overhaul of several economic processes within the Eurozone. The EC will draw plans to help solve the Eurozone crisis, including how to resume growth in Europe and a contentious Eurobond, where countries will pool their resources when borrowing money. But German Chancellor Angela Merkel has said,

“Changes to the EU treaty and stricter regulation are the way to solve the problem, rather than Eurobonds” (BBC 2011).

For sure the EU needs new regulation and fiscal policy to control government debt and improve economic growth, further more creating job opportunities and reducing unemployment rates.

**Conclusion**

After analyzing the financial crisis since the Great Depression in 1930’s, the financial crisis is major cause for economic to crush. Also the financial crisis is not a new phenomenon, most of the developed countries experienced from subsequences of
financial downturn. The conclusion of this report has shown that the financial and economic crisis was outcome of number of causes, such as collapsing financial markets, failure of financial Institutions and policy maker as well as difficulty to handle macroeconomic. This report has revealed financial crisis migrated from one continent to another, for instead in 1997 the financial crisis came to light from South Asia, Russia, Turkey and Brazil then went to US in 2007 and landed in Europe.

The aim of the report is to take the potential of Institutional and political role during the crisis, and why lessons not learned from past crisis? This report revealed most of the tiger countries blamed financial institution for deepen the crisis because the financial institution imposed difficult and tough roles to deliver such as reduce public deficit sharply and the only way to balance public deficit is to cut public jobs, and consequences increase unemployment rate, create poverty among unskilled people.

Some of the IMF policy does not suitable for developing countries such as reduce public jobs along with increase tax, also many people arguing IMF policy established in developed countries which do not suitable for another nations. In addition many of independent financial and economic expertise arguing IMF makes a decision behind close door and they are secret organisation furthermore their roles only applied toward developed countries.

The main reason for latest financial crisis started in late 2007, created by financial companies for example the careless of banking systems, allowing customers to borrow with no security deposit with take mortgage on high interest rate, in addition number of banks went to liquidation such as Northern Rock from England, Leman brother from USA, and the government stepped in to rescue them by using tax payers money. So the government allowed banks to carelessly trade in the market.

References


