Developments In Global Finance & Trade

A Presentation by

Dr. Joseph Steinman

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World Economic Developments 1948[a] - 2008

Year	World Trade*	World GDP*
1948	$404	$5,855
1998	$6,028	$33,712
2008 (est.)	$14,248	$54,347

(a) First GATT Agreement Signed

(*) Constant 2006 $billion from WTO data

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Growth in World Trade – Facilitating Factors

- Signing of first GATT agreement - 1948
  - Import tariffs decreased an avg 91% to 2008
- Increased availability & reduced costs of
  - Transport
  - Telecommunications
- Increased access to trade financing in
  - Most developed countries
  - Many developing countries
- Globalization of capital and product markets
- Establishment of trading alliances
  - European Common Market
  - ASEAN
  - Mercosur
  - NAFTA

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The Globalization of Product Markets - Causes

- **Markets are converging**
  - Characteristics becoming more & more similar
- **Preference structures are homogenizing**
  - People, companies want same products/services
- **World-wide, customers are demanding higher quality at lower costs – product standardization**
  - Characteristics becoming more & more similar
- **Artificial barriers to trade are coming down**
  - Tariffs, quotas, technical standards, etc.

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Moving Toward A One-World Economy
The Globalization of Capital Markets

- **GATT Agreement, reducing tariffs and non-tariff barriers**
  - Export & Import activity increased dramatically
  - Regulations on capital and product flows loosened
  - Foreign direct investments expanded as MNC's moved into new markets
- **Globalization of Trade and Business req'd financing**
  - Int'l flow of funds growth facilitated by growth in Int'l banking
  - Top 20 of World's Banks total assets
    - 1970 - $1.9 trillion
    - 2006 – 24.6 trillion
  - Regulations on funds flows were reduced or eliminated as technological innovation made world capital markets 24/7 businesses
    - Advantages
    - Disadvantages

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Expansion Of Multinational Business

- **Int'l business & trade expanded, so did the number and size of multinationals**

Number of Multinationals			
1960	**1970**	**2000**	**2007**
4,626	7,258	60,810	>78,000

- **2007 funds spent for foreign direct investment by MNC's - $1.53 trillion**
  - Facilities, Acquisitions, Distr. Infrastructure, etc.
  - U.S. Share; only about 19% or $314 billion with 63% of it going to Europe
- **In 2007, MNC's employed 82 million people outside their home countries**
  - Exxon Mobil - largest MNC, sales of $365 B/yr & ranking 26th among world economies
  - General Electric is largest by foreign assets with $444 billion
  - Wal Mart is largest by number of employees – 1,910,000 people
  - Hutchinson – Whampoa Ltd – largest developing country MNC by foreign assets - $70.7 billion, and 182,140 foreign employees

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Financing Multinational Business

- **FDI flows in developing countries – show most profound effect**
  - From <$20 billion in 1970 to $104 billion in 1980 to $538 billion in 2007
- **Pattern of funds flows began to change in late 1980's into 1990's**
  - Loosening capital controls in developing countries
  - Increasing portfolio investments
  - Lending by international banks declined
  - Short-term capital flows chasing high returns created economic bubbles
- **The 1990's – The decade of the serial crises**
  - Mexico - 1994
  - Asia - 1997
  - Russia - 1998
  - Brazil - 1999

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Emerging Market Crises

- **The Mexican Peso Devaluation of 1994**
  - Peso collapsed in December 94 – falling >37% in 3 weeks vs. $
  - Peso was overvalued for years - with rate maintained by market intervention and capital inflows supported by high interest rates, borrowings, more and more short term in to high interest treasuries
  - New capital spent mainly on consumer goods rather than infrastructure development
  - When debt obligations came due and were unfunded, the "hot" money fled the country causing an indefensible run on the Peso
  - The U.S. coordinated a $52 billion rescue package for Mexico
- **The Asian Crises of 1997**
  - Began in Thailand as a rapidly expanding economy drew in foreign capital
  - Bhat essentially fixed to the $ and stable but offering higher returns
  - Bad project investing came as better projects were completely funded
  - As some bad projects failed, investors began to pull $ out of Thailand
  - And then the wheels came off as Bhat became indefensible, was floated and dropped by 38% vs. $ in relatively short period
  - Some banks failed, credit became unavailable
  - Korea, Taiwan, Malasia, Indonesia and the Philipines suffered similar fates

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Emerging Markets Crisis – Cont'd

- **Collapse of the Russian Ruble – 1998**
  - Russia had not defaulted on foreign debt since the 1920's
  - In the early era of Perestroika domestic and especially foreign debt rose rapidly with major development projects
  - Declining exports with Asian crises, massive corruption by oligarchs led to diversion of state assets and falling tax revenues
  - Both government and private debt went into default leading to a large Ruble devaluation and severe inflation
- **A Crisis in the Brazilian Real**
  - Brazilian R$ held steady vs. $ by borrowing and market intervention and increased interest rates for first 8 months of 1999
  - Relative rate of inflation was increasing rapidly as capital flight began to increase in the 4th quarter of 1998
  - Foreign holders of Brazilian equity became nervous about increasing risk, sold shares with large $ outflows from Brazil
  - Bovespa dropped more than 30% in two weeks in late 1998
  - **In January 1999, the R$ was floated, interest rates increased, capital controls were imposed**

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What Did We Learn For Emerging Market Crises

- **Many affected economies were considered star performers**
- **Most of the crises were not anticipated with more dire consequences than initially expected**
- **Almost all crisis economies experienced BOP problems**
  - Substantial pre-crisis capital inflows
  - Imbalance between short-term borrowing vs. long-term investments
- **The crises led many emerging mkt countries to undertake policy adjustments**
  - Sound fiscal and monetary policies
  - Proactive management of debt structure
  - Limit private foreign indebtedness
  - Accumulation of monetary reserves

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Recent Casualty of Global Finance - Iceland

- **Characteristics**
  - The highest standard of living
  - Population
  - GDP
  - Banking
  - Household Debt
- **The Collapse – 10 days in October (2008)**
  - Bank Privatized in 2003 – borrowed heavily abroad
    - Entry into local mortgage market
    - Made numerous foreign acquisitions & joint ventures
    - In 5 years, accumulated mountain of foreign debt
    - Euro debt came due; banks couldn't pay; banks re-nationalized
    - Krona collapsed
    - IMF loan; Danish & Norwegian Credits
- **Causes**
  - Very Aggressive Banking - Carry Trade Funding
  - ***Lack of Regulatory Oversight*** - Excessive Leverage

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A New World Order?

- **Living in an inter-connected World**
  - Current World Economic Crisis
  - The loss of U.S. Dominance in World Product and Capital Markets

Recent Major Developments in Global Finance

- Massive Transfer of Wealth from U.S.
- Numerous Powerful Financial Centers Now Operating
- U.S. Government Can no longer dictate to Global Capital Markets

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A New World Order? (Cont'd)

- **Goodbye G7, Hello G20**
  - Washington D.C. Meeting in November
  - Formed to promote discussions between developed and emerging market countries
    - Recognized Standards
    - Combat fraud and abuse of the financial system
    - Play a significant role in reform of the global financial architecture

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A New World Order? (Cont'd)

- **Where Are We Going?**
  - The fallouts from unfettered capitalism becoming clear
  - Backlash against privatized profits and socialized losses
  - Likely move towards Europe's more closely regulated market-model
  - International Financial institutions will be strengthened and play a bigger role in global finance & IMF, FSF, G20
  - More Global Regulation – some possibilities
    - IMF given enhanced oversight powers – new regulations for global financial transactions and institutions
    - Creation of an international supervisory body
    - More strict regulation of speculative hedge funds

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A New World Order? (Conclusions)

- A move away from U.S. Model; market self-regulation vs. government / supra-national body regulation and oversight.
- **Objectives of a new regulatory environment**
  - Ensure international systemic stability; higher level of transactional transparency
  - Preserving market integrity
  - Protecting global capital market participants/consumers

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