Global Melting Down: Us Vs. The Rest of The World

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DEVELOPMENT AND CAUSATION

The underlying causes leading to the crisis had been reported in business journals for many months before September 2008, with commentary about the financial instability of leading U.S. and European investment banks, insurance firms and mortgage banks consequent to the subprime mortgage crisis. Beginning with failures caused by misapplication of risk controls for bad debts and collateralization of debt insurance, large financial institutions in the United States and Europe faced a credit crisis and a slowdown in economic activity. The impacts rapidly developed and spread into a global shock resulting in a number of European bank failures and declines in various stock indexes, and large reductions in the market value of equities. The credit crisis was exacerbated by Section 128 of the Emergency Economic Stabilization Act of 2008, which allowed the Federal Reserve to pay interest on excess reserve requirement balances held on deposit from banks, removing the incentive for banks to extend credit instead of placing cash on deposit with the FRB. Moreover, the de-leveraging of financial institutions further accelerated the liquidity crisis, and a decrease in international trade. World political leaders and national ministers of finance and central bank directors have coordinated their efforts to reduce fears but the crisis is ongoing and continues to change, developing at the close of October into a currency crisis with investors transferring vast capital resources into stronger currencies such as the yen, the dollar and the Swiss franc, leading many emergent economies to seek aid from the International Monetary Fund.

2009 CRISIS

On the evening of January 18 2009, the Danish Parliament agreed to a financial package worth 100 billion Danish krone (17.6 billion USD). In response, markets panicked yet again. On January 22 2009, the editorial board of The Christian Science Monitor wrote that the four largest U.S. banks "have lost half of their value since January 2, 2009." The two month period from January 1-February 27,2009 represented the worst start to a year in the history of the S&P 500 with a drop in value of 18.62%. By March 2, 2009, the Dow Jones Industrial Average Index had dropped more than 50% from its summer 2008 peak. The decline has been compared to that of the 1929 Great Depression, which was 53% between September 1929 and March 1931.On March 6 2009, the Bank of England announced up to 150 billion pounds of quantitative easing, increasing the risk of inflation. In March 2009, Blackstone Group CEO Stephen Schwarzman said that up to 45% of global wealth had been destroyed by the global financial crisis.

GLOBAL RESPONSES

Responses by the UK and US was in proportion to their GDPs.

ASIA-PACIFIC

On September 15, 2008, China cut its interest rate for the first time since 2002. Indonesia reduced its overnight repo rate, at which commercial banks can borrow overnight funds from the central bank, by two percentage points to 10.25 percent. The Reserve Bank of Australia injected nearly $1.5 billion into the banking system, nearly three times as much as the market's estimated requirement. The Reserve Bank of India added almost $1.32 billion, through a refinance operation, its biggest in at least a month. On November 9, 2008, the 2008 Chinese economic stimulus plan was a RMB¥ 4 trillion ($586 billion) stimulus package announced by the central government of the People's Republic of China in its biggest move to stop the global financial crisis from hitting the world's third largest economy. A statement on the government's website said that the State Council had approved a plan to invest 4 trillion yuan ($586 billion) in infrastructure and social welfare by the end of 2010. The stimulus package was to be invested in key areas

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such as housing, rural infrastructure, transportation, health and education, environment, industry, disaster rebuilding, income-building, tax cuts, and finance. China's export driven economy started to feel the impact of the economic slowdown in the United States and Europe, and the government already cut key interest rates three times in less than two months in a bid to spur economic expansion. On the 28th of November 2008, China's Ministry of Finance and the State Administration of Taxation jointly announced a rise in export tax rebate rates on some labor-intensive goods. These additional tax rebates took place on Dec'01 2008.The stimulus package was welcomed by world leaders and analysts as larger than expected and a sign that by boosting its own economy, China was helping to stabilize the global economy. News of the announcement of the stimulus package sent markets up across the world. However, Marc Faber, on January 16 2009 said that China, according to him, was in recession.

In Taiwan, the central bank on September 16, 2008 said it would cut its required reserve ratios for the first time in eight years. The central bank added $3.59 billion into the foreign-currency interbank market on the same day. Bank of Japan pumped $29.3 billion into the financial system on September 17, 2008 and the Reserve Bank of Australia added $3.45 billion the same day.

UNITED STATES

The Federal Reserve, Treasury, and Securities and Exchange Commission took several steps on September 19 2008 to intervene in the crisis. To stop the potential run on money market mutual funds, the Treasury also announced on September 19 2008, a new $50 billion program to insure the investments, similar to the Federal Deposit Insurance Corporation (FDIC) program.Part of the announcements included temporary exceptions to section 23A and 23B (Regulation W), allowing financial groups to more easily share funds within their group. The exceptions were to expire on January 30, 2009, unless extended by the Federal Reserve Board. The Securities and Exchange Commission announced termination of short-selling of 799 financial stocks, as well as action against naked short selling, as part of its reaction to the mortgage crisis.

MARKET VOLATILITY WITHIN 401(K) AND RETIREMENT PLANS

The Pension Protection Act of 2006 included a provision which changed the definition of Qualified Default Investments (QDI) for retirement plans from stable value investments, money market funds, and cash investments to investments which expose an individual to appropriate levels of stock and bond risk based on the years left to retirement. The Act required that Plan Sponsors move the assets of individuals who had never actively elected their investments and had their contributions in the default investment option. This meant that individuals who had defaulted into a cash fund with little fluctuation or growth would soon have their account balances moved to much more aggressive investments.

Starting in early 2008, most employer sponsored plans sent notices to their employees informing them that the Plan default investment was changing from a cash/stable option to something new, like a Retirement Date fund which had significant market exposure. Most participants ignored these notices until September and October, when the market crash was on every news station and media outlet. It was then that participants called their 401(k) and retirement plan providers and discovered losses in excess of 30% in some cases. Call centers for 401(k) providers experienced record call volume and wait times, as millions of inexperienced investors struggled to understand how their investments had changed so fundamentally without their explicit consent, and reacted in a panic by liquidating everything with any stock or bond exposure, locking in huge losses in their accounts.

Due to the speculation and uncertainty in the market, discussion forums filled with questions about whether or not to liquidate assets and financial gurus were swamped with questions about the right steps to take to protect what remained of their retirement accounts. During the third quarter of 2008, over $72 billion left mutual fund investments that invested in stocks or bonds and rushed into Stable Value investments in the month of October 2008. Against the advice of financial experts, and ignoring historical data illustrating that long-term balanced investing has produced positive returns in all types of markets, investors with decades to retirement instead sold their holdings during one of the largest drops in stock market history.

LOANS TO BANKS FOR ASSET-BACKED COMMERCIAL PAPER

During the week ending September 19, 2008, money market mutual funds had begun to experience significant

withdrawals of funds by investors. This created a significant risk because money market funds are integral to the ongoing financing of corporations of all types. Individual investors lend money to money market funds, which then provide the funds to corporations in exchange for corporate short-term securities called asset-backed commercial paper (ABCP). However, a potential bank run had begun on certain money market funds. If this situation had worsened, the ability of major corporations to secure needed short-term financing through ABCP issuance would have been significantly affected. To assist with liquidity throughout the system, the Treasury and Federal Reserve Bank announced that banks could obtain funds via the Federal Reserve's Discount Window using ABCP as collateral.

EUROPEAN UNION

The European Central Bank injected $99.8 billion in a one-day money-market auction. The Bank of England pumped in $36 billion. Altogether, central banks throughout the world added more than $200 billion from the beginning of the week to September 17, 2008.On September 29, 2008, the Belgian, Luxembourg and Dutch authorities partially nationalized Fortis. The German government bailed out Hypo Real Estate. On 8 October, 2008, the British Government announced a bank rescue package of around £500 billion ($850 billion at the time). The plan comprised of three parts. First, £200 billion was to be made available to the banks in the Bank of England's Special Liquidity scheme. Second, the Government was to increase the banks' market capitalization, through the Bank Recapitalization Fund, with an initial £25 billion and another £25 billion to be provided if needed. Third, the Government temporarily underwrote any eligible lending between British banks up to around £250 billion. In February 2009, Sir David Walker was appointed to lead a government enquiry into the corporate governance of banks. In early December 2009, German Finance Minister Peer Steinbrück indicated that he did not believe in a "Great Rescue Plan" and indicated reluctance to spend more money addressing the crisis.

POLITICAL INSTABILITY RELATED TO THE ECONOMIC CRISIS

Business Week in March 2009 stated that global political instability was rising fast due to the global financial crisis and is creating new challenges that need managing. The Associated Press reported in March 2009 that: United States Director of National Intelligence ,Dennis Blair, had said," the economic weakness could lead to political instability in many developing nations." Even some developed countries were seeing political instability. NPR reports that David Gordon, a former intelligence officer who now leads research at the Eurasia Group, said: "Many, if not most, of the big countries out there have room to accommodate economic downturns without having large-scale political instability if we're in a recession of normal length. If you're in a much longer-run downturn, then all bets are off." Forbes expressed concern saying, "The recent wave of popular unrest was not confined to Eastern Europe. Ireland, Iceland, France, the U.K. and Greece also experienced street protests, but many Eastern European governments seem more vulnerable as they have limited policy options to address the crisis and little or no room for fiscal stimulus due to budgetary or financing constrains. Deeply unpopular austerity measures, including slashed public wages, tax hikes and curbs on social spending will keep fanning public discontent in the Baltic states, Hungary and Romania. Dissatisfaction linked to the economic woes will be amplified in the countries where governments have been weakened by high-profile corruption and fraud scandals (Latvia, Lithuania, Hungary, Romania and Bulgaria)." In January 2009, the government leaders of Iceland were forced to call elections two years early after the people of Iceland staged mass protests and clashed with the police due to the government's handling of the economy. Hundreds of thousands protested in France against President Sarkozy's economic policies. Prompted by the financial crisis in Latvia, the opposition and trade unions there organized a rally against the cabinet of premier Ivars Godmanis. The rally gathered some 10-20 thousand people. In the evening, the rally turned into a Riot. The crowd moved to the building of the parliament and attempted to force their way into it, but were repelled by the state's police. In late February 2009, many Greeks took part in a massive general strike because of the economic situation and they shut down schools, airports, and many other services in Greece. Police and protesters clashed in Lithuania where people protesting about the economic conditions were shot by rubber bullets. In addition to various levels of unrest in Europe, Asian countries also saw various degrees of protest. Communists and others rallied in Moscow to protest against the Russian government's economic plans. Protests also occurred in China as demands from the west for exports reduced dramatically and unemployment increased. Beginning February 26, 2009, an Economic Intelligence Briefing was added to the daily intelligence briefings prepared for the President of the United States. This addition reflected the assessment of United States

intelligence agencies that the global financial crisis presented a serious threat to international stability. There were incidences of acute hardship and trading down at the supermarket. There was a bigger slump in the global- economy, a sharper drop in remittances sent home by migrant workers and rising pressure for social spending as the recession deepened. The cost of the recession rose. It was an avoidable disaster because people knew about the Wall Street Collapse and the subsequent rescue packages. The world economy will not recover until the raging financial sector crisis is brought under control. Several hundred billion dollars of public money have already been pumped into the economy by the developed countries. However, due to the global recession, there is rising unemployment, falling house prices and failed businesses. Extreme measures such as outright nationalization of banks- to save them from the crisis- were being contemplated. In April 2009, heads of G-20 countries met in London to discuss a number of proposals to reinvent the world financial order. There was the need for development partners to honour and even scale up aid commitments. The aid should be predictable, transparent and aligned with the policy priorities of the recipients. Countries have to economize and rationalize their spending and increase efficiency to create fiscal space for protecting social and Millennium Development Goals-related to spending.

In Africa, recession means children are taken out of school and clinics are running out of drugs. Tightening the belt means hunger, malnutrition and death. The vague promise of extra funding for the International Monetary Fund- the commitment made by G20 finance ministers on 14th March 2009- is just not good enough. In the past, a one percentage point drop in global growth led to a 0.5 point fall in growth in sub-saharan Africa. The IMF has stated that the world's poorest countries need a minimum of $25b to cope with the impact of the shock to their international reserves and in a 'bad case' scenario, they might need $140b. The promises given by the rich nations (except the UK) at the Gleneagles summit in 2005 were not kept up and were thrown in the thin air. The November 2008 Summit held at Washington failed to take effective extreme measures to solve the crisis.

Nobel prize winner and New York Times columnist Paul Krugman said that the financial sector debacle has its origin in the 'global imbalance'- the phenomenon of large current account surpluses in China and few other countries coexisting with large U.S. deficits. China and Japan need an outlet to deploy their surpluses. The U.S. has been running huge deficits. The U.S. government has made an unsuccessful efforts to persuade China (and other countries also) to revalue the yuan, making its exports less competitive. The global imbalance is reflected in large mismatches in the current account positions of some countries and its mirror image in the form of domestic savings-investment mismatches. The Asian countries spend their savings in the U.S. The flood of money into the U.S. has kept interest rates low, inflated prices of real estate, shares and other assets. When the bubble burst, the financial sector crisis surfaced. So an 'orderly' unwinding of imbalance alone will help to mitigate the crisis. If this viewpoint is accepted, macro economic politics of countries need fine tuning.

Extreme measures such as outright nationalization of banks- to save them from the crisis- are being contemplated. In April 2009, heads of G-20 countries will meet in London to discuss a number of proposals to reinvent the world financial order. The sort of fiscal shock that is looming for the low-income countries would not be tolerated in the west. Now, there is the need for development partners to honour and even scale up aid commitments. The aid should be predictable, transparent and aligned with the policy priorities of the recipients. Countries have to economise and rationalize their spending and increase efficiency to create fiscal space for protecting social and Millennium Development Goals-related spending.

France and Ireland have decided to cut their aid budgets. Indeed, developed countries are busy throwing money at the crisis in the belief that it will ease the pain. Poor countries do not have the resources to administer a fiscal stimulus to match the 5% of GDP boost delivered in the U.S. by President Obama; the only way they will be able to prevent schools from closing; more mothers from dying in childbirth ;and infants starving is if aid is increased and debt relief is stepped up. As Kevin Watkins, Chief economist at UNESCO puts it: "Africa desperately needs a massive injection of aid and support to stave of reversals in human development. So what could be done? The debts of poor countries should be cleared with the help of banks and rich people in the west. Debt cancellation amounting to at least $400bn may be done as suggested by the Jubilee Debt Campaign. The need of the time is the announcement of debt relief and a debt tribunal by the IMF and IBRD. There should be a 'fair and open' work out process for debt at the global level; and a crackdown on illicit capital flight so poor countries are able to raise more of their own capital. The IMF can boost up the money supply through an increase in its Special Drawing Rights.However, poor countries may not get much benefit from this because they got smaller allocation of SDR. The World Bank and the International Development

Association are expected to announce soft loan and ultra cheap loan facility to poor countries. Moral and political pressure must be put on rich countries to keep their pledges and promises. 53 individuals in a population of one billion held wealth equal to almost a third of their nation's GDP in 2007. Now, 24 individuals come in the Forbes Billionaires list (Forbes Billionaires list). India has fallen from fourth to the sixth rank in the list of nations with the most billionaires according to the Croesus Count. In 2007, the net asset worth of India was $335 billion which has shrunk over a third from the time of last Forbes scroll. The Nordic nations have the highest living standards in the world. India, in spite of its poor living standards, has eight billionaires -more than all the Nordic nations. Four Indians were among the world's top ten richest in 2008, worth a combined $160 billion. Today, that same foursome is worth just $54 billion. The 29 Indian tycoons were reduced to the penury of mere millionaire-hood.

Each year since 1990, the U.N. Development Programme releases Human Development Report. The Human Development Index (UNDI) is prepared by the UNDP based on life expectancy at birth, literacy rate, enrolment in primary, secondary and tertiary education, and GDP per capita measured in U.S. dollars at Purchasing Power Parity. The numbers of billionaires and millionaires doubled and trebled. But now, the numbers have shrunk. However, the number poor people have not reduced. According to Government of India report, there were at least 836 million Indians living on less than Rs.20 in 2007. Over 20 crores of people get less than Rs. 12 per day. The HDI figures since 2002 signal a continuous - fall in the nation's conversion of wealth into human development. In the UNDI, India in 1992 ranked 121 among 160 nations. India has fallen (from 128 in 2007-08) to 132 in 2008-09 among 179 nations. That is, India firms up its place in the bottom 50. China, the fastest growing economy, is ranked at 94. We have gone behind Latin America's poorest nations like Congo, Botswana, and Bollivia. Palestine, which was torn by conflict for 60 years, is also ahead of us. Sri Lanka which has been devastated by LTTE over two decades is ranked at 104- 28 rungs above India. Vietnam, which suffered from lethal bombing, deadly poisons and by American attacks, is ranked at 114. That is our worst ever grade on the Index in this decade. The little and the tiny Himalayan nation Bhutan never was in the Forbes hall of fame. It was amongst the bottom 15 nations in the U.N.'s HDI. It has never been among the world's fastest growing economies. Now it is ranked at 131 in the UNHDI.

The rate of growth of Indian Economy was 9.4% in 2005-06, and 9.6% in 2006-07. However, India's GDP per capita (PPP) fell from $3, 452 to $2,489 (with the new data for 2006). The UN researchers point out that the GDP per capita data for 2006 'caused India to raise one place.' But 'new data (for 2006) on life expectancy caused India to fall one place.' Since Montenegro and Serbia fared better than us, we also fell two more places. We fell a further two places 'as a result of revised PPP estimates. That is how we ended up four slots below our last rank

Cuba suffers from lower income. She has lived under cripping sanctions for decades.Economic Sanctions have imposed huge constraints and the prices of essential goods are high. Yet, life expectancy at birth in Cuba is now 77.9 years. This life expectancy rate is 78 in the US. The US has logged its worst rank ever, falling to 15 from 12. Between 1995 and 2000, the US was always in the top 5, even staying at rank 2 for a couple of years. Life expectancy at birth is 64.1years in India. Cuba is about 14 years better than India in the life expectancy rate. Guba logs in at 48, thus breaking into the top 50 nations in the HDI. That is 7 places above wealthy Saudi Arabia, whose per capita GDP is 3 times higher than Cuba's per capita GDP. In the field of per capita GDP, the rank of Saudi Arabia is 35, while that of Cuba is 88. India should learn lessons from fish farming agriculture and cold storage, distribution and processing of food products.

CONCLUSION

The short-term approaches taken until now have to be replaced by long-term approaches. We need a historical leap towards sustainable human activity. New technologies and mutually integrated capabilities have to be implemented so as to facilitate a smooth transition to a global economy which is less dependent on fossil fuel. Chilean President Michelle Bachelet says: "Innovation is the strategic imperative of any country that wants to give its citizens a good future." The crisis should be seen as an opportunity for a new global environment agreement that would lay the foundation for a low emission global economy to ensure lasting prosperity. The global economy should be set in motion to prevent a social collapse along with an economic collapse. A new democratic and sensitive world order is to be established. Complementary rather than competitive efforts should be taken to over come the current socio-economic crisis. Prof. T.N. Srinisavan, of Yale and Stanford Universities in the US is of the opinion that pumping in a lot of money into the domestic market would not help the economy as it cannot stimulate domestic demand. Unless

supply constraints are removed, the stimulus will not yield the desired results in the Indian context. Of course, according to him, the Indian economy did not have as much impact of financial crisis as in the rest of the world, thanks to prudential regulatory norms and controls. However, financial integration happened much faster than the real integration with the world markets in India. The US economy might grow by half- a-percent in the third quarter of 2009 and 1.5 per cent in the last quarter. The European economy too was likely to grow. This would result in Indian economy growing. He says that the Indian Economy would recover from crisis by 2010-11, if the election results and the monsoon are favourable.

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