IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 7, Issue 2. Ver. III (Mar. - Apr. 2016), PP 96-105
www.iosrjournals.org

Banking Crises

M. Tarik Dkhissi
PhD student– Department of Economics and Management, Center of Doctoral Studies, Faculty of Economic Sciences -Souissi-, University Mohammed V, Rabat, Morocco

Abstract: *The financial crisis materialized in 2007 brought back the specter of a great depression of the activity, which the economic theories believed to have stemmed since the 1929 crisis. Caused by the bursting of the "subprime" bubble and exacerbated by tensions over the sovereign debts in Europe, this latest crisis challenges researchers and economists to reconsider the instances of the past. Dutch tulip bulbs in crash of new technologies, through the Great Depression or the financial turbulences of emerging countries, should we conclude that capitalism is subject to inevitable cyclical fluctuations? Or is it recurring mistakes in economic policy that could be avoided?*
Keywords: *Financial Crisis, Financial Stability, Financial System, Financial Instability, Banking System, Capitalism, Financial Globalization*

I. Introduction

Remarkable for its intensity and its magnitude, the financial crisis materialized in 2007 brought back the specter of a great depression of the activity, which the economic theories believed to have stemmed since the 1929 crisis. Triggered by the bursting of the “subprime” bubble and exacerbated by tensions over the sovereign debts in Europe, this latest crisis challenges researchers and economists to reconsider the instances of the past. Dutch tulip bulbs in crash of new technologies, through the Great Depression or the financial turbulences of emerging countries, should we conclude that capitalism is subject to inevitable cyclical fluctuations? Or is it recurring mistakes in economic policy that could be avoided?

Analyses and studies led by the American economists Reinhart and Rogoff point out that past financial crises do not differ greatly from that of 2007-2008.Thus, the same mechanisms appear to work: blindness to risk, excessive investment in a particular sector or an abrupt adjustment of expectations. However, other authors focus, instead, on the diversity of crises: the regulationist school shows that beyond common features, they vary according to the socioeconomic regime and the institutional context in which they operate. The so-called "underproduction" crises related to war and climatic hazards have disappeared with the emergence of capitalism in favor of industrial "overproduction" crises. If the Fordist institutional compromise of the “trente Glorieuses” (post-war economic prosperity) was accompanied by a reflux, or even the disappearance of great crises, financial capitalism, booming since the eighties, has signed the return of instability that we thought to be specific to the financial systems of emerging countries.

Does this crises variability explain the trouble which researchers, economists and monetary authorities have in anticipating and predicting them?The study of the great crises of the 20th and 21st century shows to what extent public policies and economic analysis were tested. So while the slump of the thirties had precipitated the Keynesian revolution, the stagflation of the seventies has, however, convinced through its disruptive nature cyclic regulatory policies.

The recent crisis, pointing the disadvantages of financial globalization, helped trigger a movement of re-regulation of finance and reflection on the neoliberal growth model which has been predominant for almost three decades. At the option of the theoretical and practical turnovers, one thing seems clear, either during the Japanese crisis of the nineties or after the fall of Lehman Brothers in 2008: public authorities, including Central Banks, provided massive financial support to the economy for the sole purpose of avoiding the duplication of errors from previous years.

In this article, we will focus on the matter of the recurrence of crises and the limitations of the economic theory in its ability to explain the appearance of new crises and to provide solutions to these latters.

II. Crisis Recurrence: Inherent Feature Of International Banking And Financial System

Borrowed from medical jargon, the term "crisis" refers to a malfunction of an economic system. Its symptoms are the sudden drop in activity, the strong downward or upward price movements and the rising of unemployment.

Indeed, and in Hippocratic medicine, a "crisis" refers to the phase that allows healing: it is not a symptom, but both evil and its antidote. This convergence between medicine and economics took place in the

early 19th century, during the analysis of the first crises of over-production and under-consumption that stimulated theoretical debates.

On long cycles identified by Kondratieff are grafted short cycles called "business cycles" and has come to light by Juglar. The crisis is then considered as a point in the cycle, a turning point that would allow both the correction of the imbalance and sanitation system. The explanation of the crisis lies in the expansion phase that preceded the break. Therefore, the crisis corresponds to a rupture, a sharp reversal in economic conditions smashing an expansion phase.

Nevertheless, the word "crisis" has taken on a broader meaning, as it refers to the phase of depression or recession itself. However, views differ when it comes to characterizing this shift in order to identify the triggers of the crisis.

For Marxists, the crisis is linked to a major contraction of capitalism. By replacing workers with machines, capitalists caused a downward trend of the profit rate because human labor is considered the only creative source of wealth.

For the Liberals, a general crisis can only take place if the principles of free competition aren't respected. Thus, crises are then due to rigidities which should be removed because they prevent the market from functioning optimally.

Regarding the Keynesians, crises are the result of a situation of underemployment, due to insufficient effective demand which is characterized by a decline in the share of consumption in national income. In addition, the crisis occurs when this situation is not backed by investments from the government.

In fact, if the crises theories are multiple, it is due in fact to the consubstantiality of the concept of crisis in relation to the existence of markets playing the role of institutions of resource allocation. These crises do not occur, however, according to an unchanging and uniform process. On the contrary, history shows many examples highlighting a varied typology of economic crises.

III. The International Financial System: Between Liberalization, Globalization And Financial Innovation

Creating a sophisticated and branched financial industry during the years 1990-2000, was considered an asset for the most advanced countries. Financial development, expansion of the financial markets and the diversity of the financial products, were even seen as a growth indicator. At present, the financial system has become the main factor in the intensity of the financial crisis. In making the progressive dismantling of regulations instituted after the 1929 stock market crash and creating new regulation, the financial system was supposed to become effective and resilient. Periodic crises attested to its ability to absorb shocks without jeopardizing growth, even if government intervention was present, to avoid contagion of financial markets.

The 2007-2010 crisis seems to question everything. The criticism of that crisis denounces the irresponsible nature of the new finance, inevitably requiring regular and general intervention by the authorities. However, as soon as the critical phase of the crisis passes, and despite the numerous tracts against financial globalization, financial market participants resume their activities.

This leads us to ask ourselves the following question: how did governments accept this model of financial organization? How in twenty-five years of technological and ideological revolution did the finance become an entire industry, working particularly well as its regulation was vested solely to professionals? The growth of financial innovation is in fact inseparable from the double movement of globalization and financial deregulation which has guided the economic policies for the last thirty years. To understand the crisis, it is necessary to analyze this double movement: why did international financial institutions and governments, right after the crisis of the seventies, dispense with the regulations post 1929, which, by the way, had proven their worth in previous decades (1950-1970).

The seventies have revealed the exhaustion and the inadequacy of the model followed after the 1929 crisis and after the World War. In fact, the two oil shocks and the repeated financial and monetary crises have inevitably led to the collapse of "Bretton Woods" system. At that time, the Thatcher government (1979) and the Reagan Administration (1980) attempted to free the economy constrained by the regulatory framework which appeared to be obsolete.

In addition, the movement of financial market liberalization has also benefited from the launch of two flagship measures, namely the liberalization of the remuneration of savings and deposits in the United States of America and the Big Bang of the London market. In the United States of America, financial institutions have opted for banking laws (1980) not containing any regulatory interest rates as well as the introduction of free competition between various institutions. Such laws have fostered the emergence of a financial industry of which big investment banks of Wall Street are the engines.

In 1986, the Big Bang of the London Market shakes up the finance and thus places London the rank of the New York Stock Exchange rival. The new legal framework has allowed foreign companies to break into the London market through the adoption of new laws on the elimination of commissions (on the sale and purchase

of securities), giving up the separation between stockbrokers and the marker-makers[1] and the creation of screen prices. These changes have helped make London the leading financial center in the world.

Deregulation accompanies and amplifies the movement of liberalization and globalization. The end of the Bretton Woods system has thus enabled the development of foreign exchange derivatives. Stopping the use of regulated rates for deposits opens competition between different institutions. Finally, business financing is based more on financial markets, giving an increasingly important role to shareholders.

These developments should have led to a more strict regulation, intended to frame the explosion of the financial sphere, and yet, the exact opposite happened.

Note also that the succession of European and Japanese crises of the early nineties has revealed the gaps and the fragility of the financial system. These crises, including those of the United States of America, are due in particular to poor management and lack of transparency of banks that took more risks by being more exposed to macroeconomic and monetary shocks, as a result of the increasing integration of global financial markets.

Disintermediation of loans, following the opening of financial markets and deregulation, has served as a meeting platform for the agents with the ability to finance and the agents with a need for funding. These new players have started to finance themselves directly on the markets in order to invest in long-term loans or illiquid assets. Thus, banks have been directed towards other activities such as the establishment of investment banks, insurance or the securitization of loan portfolios. In this way, banks were involved in transferring risk to other financial players while increasing the risk of system liquidity.

IV. The Great Depression Of 1929

The stock market crash of 1929 is forever remembered as a financial crisis badly managed by public authorities and eventually ended up as a global economic crisis. At first it was caused by the reversal of an asset bubble, driven by loan expansion and a blind confidence in the continued rising stock markets.

In 1929 as in 2007, there were plenty of warning factors of the real estate crisis. The 1929 bubble was financed mostly by debt. Deserted beaches or wetlands attract investors, and in 1925 a down payment of 10% of funds was sufficient to purchase land and speculate on the next installation of millions of sun worshipers, desperate to escape the harsh climate of Chicago or Minneapolis.

That same year, a law allows share purchases with a 10% coverage. This encouraged households to participate in the generalized enthusiasm for the stock market. The wave of innovations that led to the second industrial revolution sparked a strong entrepreneurial wave. With the same enthusiasm, seventy years later in the bubble of the Internet, investors rush to invest in the new economy (radio, aviation, electricity ...). The rise of the stock market starting from 1927 prompted financial operators to constantly issue new shares, to increase the mergers and acquisitions that allow them to build up nebulae holdings.

Moreover, the drop in agricultural prices and the downturn in the industry, combined with overproduction in these two sectors had caused the reversal that occurred in October. Primary products and food products had continued to fall for three years. On mid-October, the stock market went up and down, before collapsing on Thursday, October 24, 1929.

Between 1930 and 1933, the world economy witnessed a series of bank failures, with a domino effect that sees creditor banks fall after the bankruptcy of their debtor, and "Bank Run", where depositors rushed to get their money, multiplied. In three years, 9,000 banks disappeared[2] and the financial panic reached its peak in the spring of 1933, where the decision was made to close all banks as a return to calm.

In this situation, the economy was living a situation of quasi-total "Credit Crunch" which suffocated companies and which caused the fall of the industrial production. And as a result, a 50% fall in industrial production, a quarter of US assets unemployed, and factories close one after the other. The dramatic effects of the Great Depression are countless and the propagation continued throughout Europe with all the economic, social and political consequences.

As such, the trauma of the Great Depression led to a rethinking of the role of the government in macroeconomic terms. The political authorities have realized, belatedly, that they had a responsibility in the case of an economic shock, and alone, the market could not achieve financial stability. Thus, the 1929 crisis encouraged the conduct of policy and regulations of the "New Deal" and the sustainable emergence of policies called Keynesian in a second time[3].

V. The Eighties Big Bang In Europe

[1] They are intermediaries that operate on financial markets.
[2] P.C HAUTCOEUR : « La crise de 1929 et ses enseignements », Dossier Crises financières, Economica 2001.
[3] E. COHEN : « Penser la crise : défaillances de la théorie, du marché, de la régulation», Fayard 2000.

After the election of Margaret Thatcher as Prime Minister in 1979, the British capitalism was going through a massive phase of deregulation, which was triggered by the elimination of exchange controls. In the late seventies, the oil countries have, thanks to the oil crisis, increased their savings and investment capacity as well as the emergence of new markets aiming to recycle the petrodollars. Now the market of the London Eurodollar had become a multicurrency international banking intermediation system. And the London market played a central role in the international liberalization of capital movements[4].

At the London markets, traders in charge of foreign exchange transactions are unable to follow the rise and the complexity of operations or to invest in financial platforms and information systems which are necessary for the rise of stock market transactions.

For the British Prime Minister, US competition requires more dynamism through the introduction of a series of reforms that shook the English financial system. Since October 27th 1986 these reforms have allowed foreign companies to take part in the London markets and resulting in the elimination of fixed commissions which were applied on trade in financial securities. In addition, the separation of the various areas of finance (stockbrokers and Jobbers) was abolished.

All these measures have attracted US investment banks which have rushed to change to the London market, and compete with British banks. This liberalization movement generates a mainstream of geographic and monetary diversification of investments, placing London in the same rank as New York; being the main and only competitor of the latter.

Following these events, all European stock exchanges follow the British model and the control of capital movements was gradually removed starting from the mid-eighties, before it was completely eliminated in 1990. It is the deregulation of the international financial system.

In France, for example, the 1984-1985 banking laws of P. Bérégovoy eliminating credit control and subsidized loans. With the financial deregulation of 1986, France joined the finance markets. Now, brokerage operations are carried out by banks, and we witness the birth of standard derivatives with the creation of the MATIF in 1986 and MONEP in 1987. Thus, French companies, which, since the post war period; were funded directly or indirectly by the government, have found refuge in the international financial markets.

With the flexibility of the regulatory framework, all market segments have experienced financial innovations, expansion of derivatives and securitization of bank loans.

During the eighties and nineties, the introduction of an international financial open-plan system allowed companies and non-financial agents to access markets and financial intermediaries in other countries and use their national currencies to invest and go into debt.

Finally, the deregulation and expansion of international capital markets were also accompanied by an evolution of the status of Central Banks. In the case of Germany, the "independent" Central Bank has focused on keeping the inflation rate at its low level. Thus, this model of Central Bank has spread in both American and European continents, and has ensured a certain conservatism in monetary policy regardless of the alternations between the parties. During this period the Central Banks have become the main players in the macroeconomic policy.

VI. Deregulation Of The American Financial System

The two oil crises of the seventies have put an end to the Keynesian model of the fifties and sixties. The concept of the "welfare state" has declined progressively during which the oil crises of the seventies, the monetary difficulties and the fall in US productivity have put an end to the expansion period of the after war.

At the end of the seventies, Friedman's monetary theory and the research conducted by the Chicago School began to question the traditional interpretation of the crisis of 1929. However, we must distinguish between the traditional economic work of Friedman on currencies or on inflation and such theses, which is much more controversial and political.

With the election of Ronald Reagan to the presidency of the United States of America in 1980, he put an end to the post war theory of Keynesian State as well as to a certain control of the federal state on economic affairs. Financial deregulation deployed in this context goes with a broader deregulation movement (telecommunications, postal services, energy ....) which assumes that the regulation has a cost, it harms competition.

Financial regulation, following the thirties, appeared to be inadequate to the developments of the seventies, especially after the decline of the Bretton Woods system and the transition to a floating exchange regime in 1976. In 1975, the government adopted a law which stipulates the elimination of fixed commissions on securities in order to encourage banks to leave their traditional setting. Starting from these years, the US banking system has experienced a severe crisis due to the existence of a system of 15,000 banks in the entire territory. In addition, each US state has its own financial system.

[4] A. BRENDER et F. PISANI : « Les déséquilibres financiers internationaux », La Découverte 2007.

At that time, US banks were underdeveloped and did not enjoy comfortable commissions generated by all the activities they could practice. Moreover, they did not have large reserves (deposits and savings of commercial banks customers) nor a network of locally set up branches on which had supported the European banks.

Furthermore, US banks had to face the limits of their traditional financial intermediation role (collecting deposits and granting loans). However, starting from the seventies, the banking system has evolved allowing households to diversify the banking products held. Thus, credit conditions have also changed dramatically following the change in interest rates during this period. On the other hand, new risks have emerged and the then system was no longer able to contain them well[5].

Thus, the financial intermediation in the United States of America is challenged by another logic driven by a thriving non-bank financial industry. During this phase, the US economy was based on a highly developed market finance, despite the traditional nature of its banking system.

VII. The Crash Of 1987

The 1987 crash occurred at a time when the first mechanisms of deregulation were starting up, the financial markets were being developed and the first derivatives were born. This is the only crisis not questioning derivatives and where the market was only acquainted with the exchange of simple products such as stocks and bonds. However, it is considered to be the first crisis of the modern era following the development of information technology and the rise of financial innovation.

Indeed, it is a period marked by the first wave of "LBO"[6] and by massive mergers and acquisitions in which investment banks such as "Bankers Trust" or "Drexel Burnham Lambert" occupy the front stage by offering a multitude of opportunities to their clients.

During the eighties, several insider trading were noted[7]: the Junk of Michael Milken, which led to the bankruptcy of Drexel in 1990 on one hand, and the insurance portfolios on the other hand, which contributed directly to the fall of the stock market in 1987.

According to economists and researchers, this crash is specifically difficult to analyze, because no economic, political or financial incident seemed to have triggered it. For others, this crisis is the consequence of the new tax laws on capital, the variations of the dollar and the trade deficit of the United States of America. It remains, however, the biggest stock market crash in history after that of 1929 when the New York Stock Exchange reached the lowest levels.

The crash of 1987 revealed that the financial markets had known a growing interdependence, particularly between the different exchange markets, equity markets and debt markets. In addition, currency fluctuations helped play a key role in the onset of the crisis and both bond markets and equity markets experienced dramatic losses. To address this situation, the only measure that has been taken by the US Congress was the launch of "Cut-Circuits" to halt sales of securities that have experienced sharp decline in their value or vice versa. However, this measure has caused controversy in markets, considering that stopping the operation of the market could create a strong feeling of anxiety and volatility. This has strengthened the ideology according to which the financial markets have the capacity to self-regulate themselves. With government intervention and more particularly that of the central bank (FED), the US economy was able to save itself from a financial disaster.

VIII. The Rise And The Risk Caused By Derivatives

During previous centuries and even before, people expressed a feeling of fear vis-à-vis future events and especially the price changes in the activities that existed at the time. Since ancient times, farmers had opted for futures to liquidate their production, even before the end of the harvest. Thus, the farmer was safe to sell his future crop at an agreed price and he could even get an advance on the selling price. As for the buyer, he had a supplier and could sell the crop at a higher price. This system allowed the farmer to hedge against the price change and the buyer to speculate on the market in order to earn more. Another example is the Netherlands, the forward sales of tulips were quite common in the 17th century. And in both cases, the buyer seeks assurance of supply of scarce commodities.

It was not until the late 19th century that trade OTC disappeared. The first organized markets have emerged since 1880 in the United States, allowing some to protect themselves against risks and others to speculate freely. The standardization of contracts and role of the market in the exchange (notably through the creation of a clearing house) helped regulate the lack of liquidity and manage the risk of default.

---

[5] M. AGLIETTA et A. REBERIOUS : « Dérives du capitalisme financier », Albin Michel 2004.

[6] Leveraged Buy-Out (LBO) is a generic term referring to a legal and financial arrangements of leveraged buyout, that is to say, by using a strong bank debt.

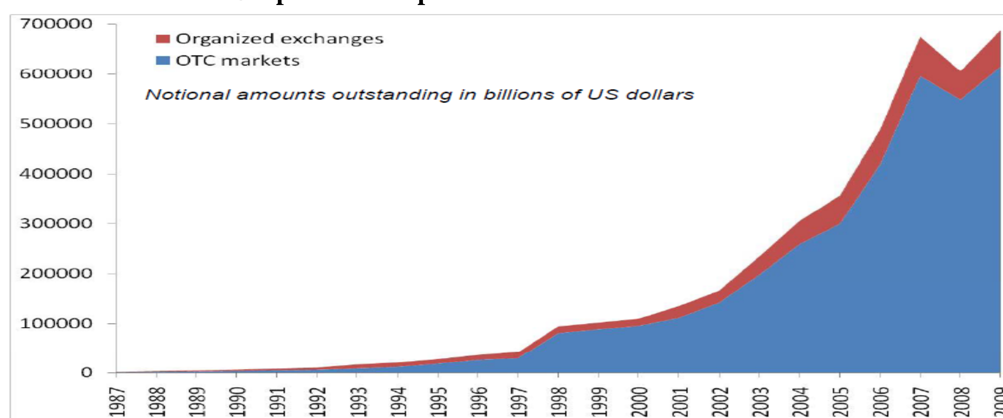
[7] D. B LEVINE: « Repenti : Wall Street, confessions d'un golden boy », Payot, 1993.

And it was not until the seventies that the first modern derivative products were launched. Their appearance is the result of two events. The first was the financial uncertainty that prevailed. Due to the abandonment of the fixed exchange rate regime of Bretton Woods and the floating of currencies as well as the rise in oil prices, all events have led investors to take the necessary measures to deal with additional costs and therefore, a decline in profit. The second event was the model of the evaluation of options developed by Merton, Scholes and Fischer in 1973. Their model was used to evaluate financial derivatives and especially to launch new instruments meeting the needs of companies in terms of management risks.

With the accelerated process of financial globalization, a financial market has appeared with the objective of negotiating, not the assets, but the risk itself. Since 1980, options on commodities, currency and rate have become the quintessential innovation field constantly offering new products to meet the demands of modern treasuries.

For over thirty years, the derivatives market has grown steadily. In 1998, the value of these products increased to 64 000 billion dollars; 60 times more than in 1986. In the first quarter of 1998, this growth reached 75 000 billion dollars, and 80 300 billion in the second semester, knowing that the market value of the underlying accounted for only 3 230 billion, or 4% of the total. These derivatives have encouraged the creation of a bubble and a proliferation of short positions.

Graph 1: The expansion of derivatives markets 1997-2009



Source : ISDA Market Survey until 1997 and BIS Quarterly Review since (June 2010, Semi-annual OTC derivatives statistics at end-December 2009; Table 19) for OTC markets; BIS Quarterly Review, June 2010 (Statistics on exchange traded derivatives; Table 23A) for organized exchanges.

In July 1994, Ibrahim Warde, a researcher at MIT, wrote in "Le Monde Diplomatique" that a bursting of the speculative bubble might occur, which led some government agencies to express concern about it. However, the large financial institutions have objected strongly to any control by the supervision monetary authorities. As such, Alan Greenspan, Chairman of the US Federal Reserve has opted for the maintain of the status quo and even dissuaded the US Congress to legislate on the subject, justifying this by the fact that self-regulation of operators plus the market sanctions is largely sufficient to maintain the stability of the US financial system.

Thus, the increased volatility reached a peak where the line between speculation and hedging has become increasingly blurred making the products lose their original vocation. Given their risk, some companies have even liquidated their portfolio of derivatives. Despite all their sophisticated models in this area, namely by Scholes and Merton, the hedge fund LTCM went bankrupt and that, following the negotiation of derivatives.

In 1997, the Financial Accounting Standards Board (FASB) proposed changes in accounting standards regulating derivatives in order to make them more binding. This reform has faced a fierce opposition from lobbies of Wall Street including the FED. Following the Enron[8] scandal in 2002, the SEC began to improve the reporting of derivatives.

IX. The Asian Crisis 1997-1998

During the thirty years prior to the Asian financial crisis, several economies in the region[9] were able to achieve significant economic performance characterized by high and fast growth rate, a low rate of inflation, macroeconomic stability, strength in public finance, high savings and prosperity of exports. Therefore, it is not

[8] Enron went bankrupt following the losses caused by its speculative operations that had masked its earnings through accounting manipulation.

[9] Korea, Indonesia, Malaysia and Thailand.

surprising that no one anticipated the onset of the crisis. But in hindsight, it is obviously easier to determine the causes that have led to the emergence of the crisis.

According to Stiglitz[10], chief economist of the World Bank at the time: "No other business model has offered this much, to so many people in such a short period". A report published by the World Bank a few months prior to the outbreak of the crisis states that the South East Asian countries have experienced an economic boom; more than 9% per year growth over the last ten years and have reduced considerably their level of poverty.

To a large extent, these countries have been victims of their own success. Asian countries have refused to see problems when they began to appear. Believing themselves immune to a crisis like the one that shook Latin America in the eighties, since they were not confronted to heavy budget deficits, or to the burden of public debt, or the rapid monetary expansion or structural impediments that made Latin America vulnerable, Asian countries have started too late to take their problems seriously.

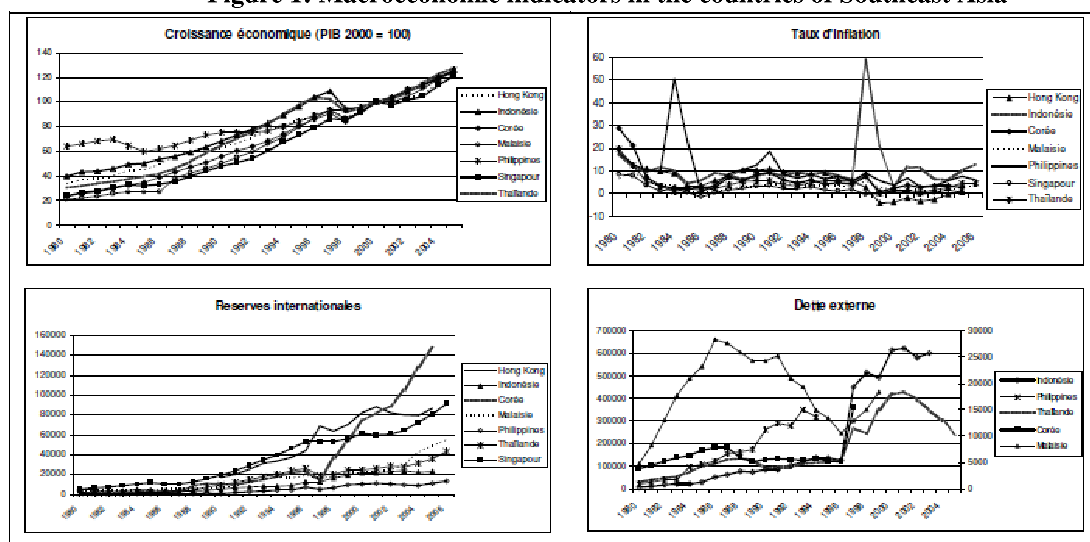
In Asia, Thailand was the starting point of the financial crisis in the summer of 1997. She experienced severe banking problems at the end of 1996, pushing the Central Bank to massively liquidate it on the market. The IMF warned the authorities in early 1997, but it was difficult to convince them of the seriousness of the problems that were emerging. This warning was not made public, because that would have precipitated the crisis it was intended to prevent. After several speculative attacks since May 1997, Thai monetary authorities were unable to defend their currency (baht) which was much depreciated. The IMF did not measure the full extent of the problems in Thailand, because it was unaware that almost all reserves of Thailand had already been engaged in the futures market. Similarly, the IMF did not know that Korea had no currency reserves; until assistance is called for from the Fund. Thai financial crisis has spread to all countries of the region.

The root causes of the Asian crisis have been formally identified. On the one hand, investors looking for new opportunities have directed their foreign funds to Asia because of the relatively low interest rates. And as in every phase of expansion, equity and real estate prices soared, attracting more investors. But the internal allocation of these borrowed foreign resources was inefficient, due to the fragility of the banking systems, poor governance and lack of transparency in the financial sector. Moreover, the limited absorption capacity of these countries has also contributed to the inefficient allocation of foreign capital. On the other hand, the countries maintained fixed exchange rates encouraging borrowers to take on more debt in dollars. Finally, in countries affected by the crisis, exports were weak in the mid-nineties for a number of reasons, including the appreciation of the US dollar against the yen, the devaluation of the yuan by China in 1994 and the loss of some markets with the entry into force of the North American Free trade Agreement (NAFTA).

The massive capital flows to Asia and the fall in exports of Asian countries have worsened the current account deficits. Moreover, the situation has only become worse since a substantial part of capital inflows was in the form of short-term debt, exposing the country to external shocks.

When the crisis erupted in Thailand in July 1997, all Asian countries have become very vulnerable and markets began to excessively overreact, so as to avoid contagion. However, the consequences of this crisis are inevitable in many Asian countries but to varying degrees. Thus, creditors withdrew their capital from the region and the crisis spread.

Figure 1: Macroeconomic indicators in the countries of Southeast Asia



Source : IMF Database -« International Financial Statistics »-

[10] A. Singh : « Asian Capitalism and the Financial Crisis », Center for Economic Policy Analysis, WP n°10, 1998.

The IMF action did not take long because of the urgency of the desired financing by Asian countries so as to cope with the liquidity shortage caused by capital flight and the collapse of their national currencies. The intervention of the IMF aims to restore confidence in markets, through colossal loans granted to countries affected by the crisis and in particular the help of some countries of the region and of the Group of Seven (G7). Finally, it should be noted that crises are inevitable as long as financial markets exist; there will be boom and bust cycles.

X. The Internet Bubble

At the end of the nineties, the development of the Internet has created new vocations. In the digital era, the traditional economy was gradually transformed into virtual economy. Yet the transition to this new economy proved fatal to many companies. But some of them were able to respond and implement new strategies, namely, in funding.

The Internet bubble or the so-called "dot-com bubble" is a speculative bubble that has affected the fields of Information and Communication Technologies (ICT) and New Information and Communication Technologies (NICT) in the late nineties. Thus, the massive creation of new businesses called "Start-ups" had an impact on the price of technology products. This phenomenon, which began in the United States of America and then spread to Europe, has led to an overvaluation of the value of companies in relation to the actual price of the goods or assets exchanged. Totally aware of the opportunities that Internet has to offer; several small companies have been created or developed by the funds injected by investors during this decade.

Internet has allowed information dissemination, a much faster and cheaper access to it. It is a major element in the innovations that marked the 21th century and is part of the NICT. These latters have turned the mode of operation of the global economy upside down. Indeed, the reconciliation and the merging of IT and telecommunications and Internet developments have enabled an unprecedented expansion of different forms of communication and a transfer of access to knowledge. All this was accompanied by an unprecedented acceleration of the pace of innovation and the dissemination time as well as a continuous cost reduction.

In March of 2000, the Internet bubble reached its peak when the Nasdaq peaked at 5 048.62 points, and the bubble finally burst causing, subsequently, the bankruptcy of several companies worldwide. As a matter of fact, the Nasdaq hasn’t reached this level since.

Figure 2: The evolution of the Nasdaq values

Source : IMF Database -« International Financial Statistics »-

XI. The International Economic And Financial Crisis - The Subprime Crisis

The subprime crisis, which began in August 2007 in the United States of America, is far from over. It has impacted the essence of the international banking and financial system, not only the mortgage loans granted to risky US households. It made economists and researchers ask questions about the benefits and drawbacks of securitization procedures, the role of financial innovations in risk transfer, the internal risk control and even the organization of systems of prudential control and banking supervision, as well as the general system of banking and financial regulation.

The crisis on the US mortgage market emerged in 2006. Loans were granted to households with modest incomes and which did not have the right to access a conventional mortgage. As such, the granting conditions constituted a credit risk on these people. In a first period, monthly payments were very low because of the loans taken at variable and low interest rates. In 2006, the "subprime" loans constituted 24% of the new housing loans granted in the United States. At the end of the year, their amount outstanding reached nearly 13% of total

mortgage loans be it 10,200 billion dollars against 8.5% in 2001. At the end of 2007, the volume of loans granted, in the United States was 1 300 billion dollars (be it 13% of total housing loans). Thus, the "subprime" loans development has allowed homeownership to many American homes.

This deterioration of the situation is the result of lower property prices in the US and the sudden rise in interest rates. This situation has created a movement of non-payment by customers with poor credit at high risk and thus to the bankruptcy of a number of specialized institutions in the United States. Falling real estate prices below the collateral value has caused a deterioration of the situation which became dramatic nationally or internationally.

Given that low-income households are much more sensitive to rising interest rates and real estate prices have fallen before, it is the poorest households that were forced to sell their property to pay off the banks. This massive sale resulted in a fall in prices in the property market. The result is that banks can no longer compensate, and therefore a series of bankruptcies hit the banks.

Lower prices in the real estate market and the non-repayment of housing loans have encouraged the emergence of the crisis in the US housing market which later spread to the credit market. The transmission channel of the crisis to the financial markets at risk has been the securitization. The latter is a financial technique by which traditionally illiquid receivables which are kept by their holders until maturity are converted into tradable and liquid securities.

Figure 3: Interest rate of the FED

Source : IMF Database -« International Financial Statistics »-

The insolvency of debtors and the falling property prices have caused the collapse or bankruptcy of several companies of subprime mortgages which were at risk. For example, the "New Century Financial Corporation" whose market share fell by 90%, causing the collapse of the share price of the credit industry. Large banks that finance these specialized financial institutions also suffer from these bankruptcies by calling for early repayments. Moreover, some banks were actually shareholders in these specialized credit companies. To address the lack of liquidity, specialized credit institutions have resorted to credit lines granted by large banking groups such as "Citigroup" and "HSBC" and to the issuance of short-term securities. Following the outbreak of the crisis, they faced a serious payment default.

Facing this situation, the US government has taken a series of measures to prevent that households find themselves in default of payment and are thus forced to sell their homes. It has suggested modifying the rules of the "Federal Housing Administration" in a way to relax the refinancing conditions required from borrowers. These suggestions also include the tax system in order to shelter the write-offs of the value of a home by financial institutions from federal taxes. Nevertheless, the action of the US authorities is very weak given the scale and impact of this crisis.

In a climate of uncertainty and panic, the banks stopped lending to each other, which resulted in a liquidity crisis. This situation has caused a significant threat to the banking sector and the economy. In order to refinance, the banks started to sell their assets to avoid illiquidity or bankruptcy situation.

During the period from June 2007 to early 2009, banks had lost about $ 700 billion, and major stock indexes fell from 40 to 60%. With the succession of bankruptcies of major banks, experts believed that the said crisis was limited to the financial sector and that it could not be transmitted to other sectors of the economy. In reality, the transmission of the crisis to the real economy was done through two complementary mechanisms:

✓ The credit channel: The first channel of the crisis transmission is the reduction of credit supply. Following the crisis, banks have found themselves in a tight liquidity situation and therefore unable to distribute loans to companies and households. Faced with this situation, banks have increased their interest rates and creditors began to demand very high risk premiums following the crisis of confidence prevailing in the markets. Thus, the decline in loans granted to SME has caused a downturn of the economic activity, a decline in household spending and therefore the occurrence of bankruptcies and rising unemployment.

✓ The channel of the depreciation of movable and immovable assets: Falling real estate prices and stock prices have led to a depreciation of household wealth. Therefore, they are obliged to reduce their consumption and save more because of the decline of their heritage. Thus, the restriction of access to loans of US households is linked both to the difficulties of banks and the deterioration of their personal situation. As for listed companies, they were affected by the decline in their share price making the raising of funds on the markets very difficult. In addition, companies were struggling to obtain financing through the issue of new shares (capital increase) because of the abstention of investors to acquire shares in this same context of crisis.

XII. Conclusion

The high costs of financial crises have pushed the supervisory authorities and researchers to engage in further discussions in order to determine the underlying causes for the occurrence of seizures. In this context, preservation of financial stability has become a priority objective of central banks.

We have shown that the international financial and banking system has undergone many phases of instability, more or less intense. The growing interdependence of economies and financial systems has insured that the recurrence of crises becomes intrinsic to the financial system.

The evolution of the economic theory under the influence of the various banking crises and, particularly the banking crises models, enabled the identification of two central methodological frameworks. The first focuses on approaches explaining the rise of risk and financial instability in the credit markets. And the second, constituting a sort of extension of the previous model, focuses on the size of runs and bank panics. Both types of models emphasize that the onset of a crisis is conditioned by an increase in financial risk, leading to a situation of financial instability.

References

[1] A. BRENDER et F. PISANI : « Les déséquilibres financiers internationaux », La Découverte 2007.
[2] A. Singh : « Asian Capitalism and the Financial Crisis », Center for Economic Policy Analysis, WP n°10, 1998.
[3] D. B LEVINE : « Repenti : Wall Street, confessions d'un golden boy », Payot, 1993.
[4] E. COHEN : « Penser la crise : défaillances de la théorie, du marché, de la régulation», Fayard 2000.
[5] M. AGLIETTA et A. REBERIOUS : « Dérives du capitalisme financier », Albin Michel 2004.
[6] P.C HAUTCOEUR : « La crise de 1929 et ses enseignements », Dossier Crises financières, Economica 2001.