Financial Crises Between the 20th and 21st Centuries

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Abstract

The economic crisis that hit the world economy in the summer of 2007 is unprecedented in post-war economic history. Although the current crisis has many features in common with past similar recession episodes. The crisis has been preoccupied with a long period of rapid credit growth, low risk premiums, abundance of liquidity, a strong leverage, rising asset prices and bubble development in the real estate sector. Economic activity is characterized by cyclicality, with periods of decline being a normal component of an economic cycle. Crises are not a new phenomenon, but over the last 100 years, due to the acceleration of the pace of economic development and the enormous advances in technology and communications, the frequency of such phenomena has increased.

Key words: economic and financial crises, cyclicality, financial developments
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1. Introduction

The economic situation of the various countries has been an important subject for anyone but especially for economists.

Nowadays, economic phenomena are carried out in a very rapid and profound manner, evolution taking into account various factors such as social, political, cultural, and last but not least, those in the field of information technology and technology.

The media, for example, is capable of transmitting as soon as possible information about what is happening in a corner of the world in the other corner, regardless of weather, time or season.

Thus, when the first signs of the current crisis began to be observed, the whole world was alert in only a few hours.

2. Theoretical background

In the opinion of economists and monetarians, financial crises appear as a form of manifestation of banking crises, with an impact on financial stability and collapse of financial infrastructure in the absence of central bank intervention (Totir F.C., Dragota I.M., 2011).

There are two basic elements that make up the destabilizing mix that leads to crises: the psychological mechanism of the emergence of periodic "irrational exuberance" waves, and the financial and banking system, which feeds and allows the ballooning of "investment balloons" (Marginean S., 2011). Of course, public authorities have long taught that it is necessary to prevent, through monetary, fiscal and regulatory policies, the emergence of such destabilizing movements in the financial markets. Ultimately, it could be said that the central bank controls the amount of money in the system and can strangle any overpriced increases in investment asset prices. But, traditionally, central banks are focusing on inflation control, following the Consumer Price Index, which does not adequately reflect developments in investment asset prices such as real estate or stock-exchange trades. In addition, the central bank has some constraints on both the tools of action

it has at its disposal and the information at its disposal. Minsky is the one who draws attention to the most important and often neglected argument: banking and financial innovation. Banks are constantly looking for new ways to respond to customer needs, inventing new products and services, and setting new mechanisms and processes through which markets become more efficient. Although the central bank controls the amount of money in the economy, it can not control the speed of money circulation that can grow due to banking innovation that makes markets more efficient. Banking innovation makes the effectiveness of the central bank's control over the monetary base to decrease over time (Paun C., 2010).

3. The most important crises in the last hundred years

"**The 1907 Bankers' Panic"** - This crisis was caused by the collapse of the banking system. The existing economic system at the time had massive cash withdrawals, which led to the bankruptcy of several banks. The population's confidence in banks has fallen sharply.

With the desire to save the situation, the US Treasury is wasting billions of dollars. Billionaire J. Pierpont Morgan came up with the solution, saving the nation's situation. He summoned a bankers' meeting where he decided to set up a federal reserve fund that could be used by banks facing massive cash withdrawals. In 1913 this fund was transformed by the US Congress into the Federal Reserve (Bank) of the United States.

Great Interwar Depression 1929-1933 - This crisis affected all branches of activity and shook the world. It broke out on Wall Street on October 24, 1929, also called the "Black Thursday", due to the considerable drop in shares in the New York Stock Exchange. After the collapse of the shares, bankruptcies began to appear.

The causes that generated this economic decline were:

- Technological cycles in the production process, generated by the replacement of older technical means with some more efficient ones.
- Unprotected production and financial lockout
- Destruction of products to avoid too high prices.

During this crisis, the industrial production of several states suffered. Alongside the industrial crisis, there has been a crisis in agriculture.

In the US, there was a 65% decrease in production, 86.1% in England, 65% in Germany, and 77% in France. Only after 1933 there was a recovery in the economy.

Oil Crisis 1973 - It began on October 15, 1973, and was generated by the decision of the Organization of Arab Petroleum Exporting Countries (OAPEC) to stop deliveries of oil to the US and other countries that supported Israel in the Yom Kippur War. Oil-supplying countries have used this natural resource as a weapon, raising the barrel price from $ 3 to $ 12 (a 300% increase).

Souk Al-Manakh Kuwait 1982 - Souk Al-Manakh Kuwait is a stock exchange operating in parallel with the official one and on which risky financial instruments were traded. In 1973, after the oil price exploded, stock indices increased considerably, and many Arabs were enriched. In 1977 the official Kuwait scholarship broke. A consequence of this was the adoption by the Government of very rigid trading rules. This has prompted speculators to trade on the unofficial Souk Al-Manakh Scholarship. As a result of this crash, all commercial banks in Kuwait, except for one, went bankrupt or were nationalized.

Black Monday 1987 - October 19, 1987 has remained in history as the day with the largest stock market declines of all time. During this time, the US economy began to set rates, but in spite of this, the DJIA (The Dow Jones Industrial Average) reached a maximum of 2722 points in August 1987, or 44 % more than at the end of the previous year.

DJIA declined in one day by 22.6% on October 19, generating $ 500 billion in company capitalization.

The Mexican crisis 1994 - Before this crisis occurred, there was a very high economic growth in Mexico, and due to the fact that the exchange rate was kept under control, economic imbalances were growing too fast. Before the allegations, the President of the Administration, Carlos Salinas de Gortari, decided to inject a lot of money into raising salaries and pensions, thus increasing the budget deficit to an unsustainable level. Gotari lost the election, and new president Ernesto Zedillo has decided that it is better to let the national currency fluctuate freely. Due to the previously

accumulated tensions in the economy, the national currency devalued 80% (from 4 to 7.2 peso / dollar) versus the dollar in just one week (Haralambie G., 2011). The situation returned to normal in three weeks, when the US intervened by buying peso directly from the market and securing a $ 50 billion loan. The currency stabilized at 6 peso / dollar.

Asian Crisis 1997 - In July 1997, in Thailand, the local currency (bath) devalued massively after the government decided to leave the currency. Thailand almost went bankrupt because it also had a huge external debt at that time. The crisis spread very rapidly in the area and covered all of South-East Asia, including Japan. The most affected countries were Thailand, South Korea and Indonesia. These countries were helped by the IMF with a $ 40 billion loan to stabilize foreign exchange rates. After two years, the affected economies have begun to recover.

Russian Financial Crisis 1998 - This crisis was caused by the Asian crisis that had the effect of lowering the prices of raw materials whose export was Russia 80% dependent. This country has decided not to honor its external debts by ending payments. Prior to 1998, the government issued bonuses to cover deficits, but when they matured, they were paid by issuing new bonds, the debt being "rolled". The interest for these bonuses was 150% per year. On August 13, 1998, this pyramid scheme fell, after the exchange and the exchange rate collapsed. The recovery of the economy began in 1999-2000.

Argentina's economic crisis 1999-2002 - In the early 1980s, Argentina went through a war with England (the war on the Falklands) through a military dictatorship, with inflation reaching a level of 200% in July 1989, per month, and public debt is unsustainable. The population began to massively withdraw their money from the banks in 1999, change them in dollars and pass them across the border. The situation degenerated when the deposits were frozen for one year by the Government. Extremely violent popular riots took place.

4. Causes and effects

At the basis of transmitting the negative effects of the crisis in a country such as the US to other, smaller or larger countries, there is the increasing interdependence of national economies in the context of increasing the globalization of all markets, including financial markets. The economy of a country is no longer able to function normally if its financial system is paralyzed or stuck. This is due to multiple interference with other national and international financial systems.

Knowing in depth the causes that have created a crisis is absolutely necessary to be able to act on the negative effects of the crisis. It is also necessary to coordinate organic and short-term, medium and long-term organic policies at all levels (local, regional, national and international).

The crisis that the world economy is currently crossing reveals the intermingling of specific, non-traditional causes of crisis phenomena, with some common, traditional ones (Marginean S., Orastean R., 2011).

The main traditional causes of economic and financial crises are:

- the boom of rapid growth in lending in very large proportions
- strong asset price growth, especially in the real estate market
- uncontrolled lending to economic agents less or no solvable.

The particular non-traditional causes that triggered the October 2008 crisis were:

- uncontrolled expansion of a unique origin model and transfer of transferable risk
- foster growth in demand for high-risk assets through exaggerated appetite for profit
- ignorance and uncertainty regarding the risk characteristics of the securities
- inadequate managerial incentives and inadequate governance of corporations in financial institutions
- the role of rating agencies and regulators.

In developed countries, in the US, but also in emerging economies, these specific causes are found in different measures. Careful analysis of the causes, with regard to the depth and magnitude of the crisis phenomena, should be done not only to identify and sanction individual and / or collective guilty and direct and / or indirect culprits, but also to better understand the mechanisms and complex causality of the phenomenon.

The effects of the international financial crisis are multiple and are reflected in different measures in affected countries. An enumeration in this sense of economic and financial effects provides a basis in this area for deepening research, but also for clarification and classification by several methods and analysis criteria. I will refer to some aspects of the long-term effects of the crisis.

So far, the most important effect is the failure of banks and credit of the United States and member states of the European Union, as a consequence of the entry of default, especially in real estate, and recovery of claims.

The IMF expects global losses caused by the financial crisis to be about $ 1400 billion. This figure is a preliminary one, subject to constant review, due to unsecured assets and bad loans. The figure for the loss is already at the IMF's second revision, which estimates a loss of 1300 billion dollars in September 2008 and 945 billion dollars in April.

Due to these losses, economic analysts predict a slowdown in global economic growth as a result of a decline in output in developed countries and a slowdown in economic dynamics in emerging economies.

The decline in the US housing market (which will continue) will have effects such as deteriorating the credit sector, an increase in mortgages and real estate transactions (corporate or retail loans), will influence the European economy, which will leads to tightening economic and credit stagnation conditions, and cheaper housing.

A stagnation / fall in GDP is expected in some EU Member States, especially in France, Germany, Italy, Estonia and Lithuania.

Unemployment, rising interest rates, devaluation of national currencies, rising inflationary pressures and rising public debt and current account deficits are other effects caused by the economic and financial crisis.

5. The role of the banking system in the propagation of the economic crisis

Banking services grew strongly in the 1980s as a result of a process of reducing the degree of regulation that allowed, among other things, that banks access capital markets in new ways. An important regulation is known as Glass-Seagall Act. It was implemented after the Great Depression in 1929 as a measure of protection and resulted in the separation of the commercial bank from the investment bank (which has stock market activity). Thus, commercial banks could independently assess the activity of companies and prohibit them from engaging in insurance and real estate activities (Peicuti C., 2011). The interruption of the connection was intended to prohibit a bank from granting loans to an enterprise and at the same time selling shares to the same undertaking, which would create a conflict of interest. Although beneficial in many ways, this regulation has prevented banks from taking advantage of economies of scale and positioning US banks at a disadvantage in international competition. Against the backdrop of economic growth in the 1990s and after intense lobbying from these banks, deregulation tendencies have become increasingly strong and the Glass-Seagall law has been abolished. The resulting trend was mergers and acquisitions between banks of various categories, creating very large and powerful banking institutions. This trend was fueled by the general market growth of the 1980s and 90s. Banks have also adapted their offer to meet the demands of an increasing number of customers seeking major investment locally or internationally, but and for those customers who used the money to trade on the stock exchange. Thus, at the end of 2000, the top 10 international banks held 80% of the market share, and of these four European and three US banks provided universal service.

In the coming years, the pace of creation of new financial instruments grew even more, leading to an increase in the rate of profitability for non-bank financial institutions. Banks have been encouraged to compete with such institutions in the desire to become more stable and more profitable. The logical result was the diminishing of the clear boundary between financial and non-banking financial services. Against this background, the 2008-2010 economic crisis has brought a wave of bank failures and destabilized the highly interconnected system. The degree of interdependence between financial institutions at international level had two adverse consequences for the entire economic system.

The bankruptcy of an institution destabilized other banks either through the direct links between the two institutions or the reaction of the clients (who were quick to withdraw their money)

Existing links, and especially financial assets traded between banks or between banks and other banking institutions, have played an important role in the spread of the global economic crisis.

Banks played an important role in amplifying and propagating the crisis due to the use of the main banking instrument: credit. It has an important role for two reasons. First of all, the purchase of financial assets is largely on credit, which leads to an increase in the prices of financial assets. Unlike the consumer goods market where price increases lead to a reduction in demand, the financial assets market behaves differently. A second reason is that due to titration the credit that can be granted by banking institutions. The more credit is made available, the higher the price of financial assets and more and more comparators are encouraged to pay. They can guarantee credits through purchased assets that are more and more expensive. This dynamic has caused the outbreak of the 2007 real estate crisis (Peicuti C., 2011).

Currently, at the level of 2012, the efforts made to stabilize the system and to avoid a repetition of the situation can be noticed. Many categories of participants are involved in these actions precisely because of how they are affected by a collapse of the banking system.

Of the most important participants I remember:

- Governments - whose involvement is manifested through legislative measures and monetary policy decisions. Thus, there is a general trend to increase the degree of regulation of financial and banking institutions.
- Special surveillance and control institutions
- International financial institutions, including those with a banking role.

6. Conclusions

The banking system is particularly complex because of the multiple ways in which it acts on the overall economic system. The main role of banks is to attract financial resources in the form of deposits and to capitalize them in order to obtain profit.

At the level of activities, however, there is a strong diversification of the operations executed by banks. Diversifying the work of these institutions changes how they affect the economic system as a whole. The latest economic crisis highlights this. Due to the large number of financial instruments and the increasing complexity of transactions between the various financial institutions, major system failures have prompted the international crisis to spread the crisis.

For the whole of the European Union, the crisis has revealed some errors in the international financial system and has destabilized the classic conceptions that some institutions are too big to fail. The dependence of the European economic sector on the functioning of the financial and banking system has led national governments to intervene to avoid further adverse effects in the future.

Economic cycling is a known and proven phenomenon on many occasions. The lack of a set of anti-cyclical measures that can be implemented in similar situations is a major weakness of the European economic system.

One of the most important factors in the propagation of the crisis was the circulation of banking assets between institutions. The possibility of reselling risky assets as part of low-risk packages is a relatively recent practice, which has been favored by some leaks in the US and European regulatory system. At present a considerable effort is being made to strengthen control over financial institutions, but their increasing negotiating power could lead to similar effects in the future.

The 2008-2010 crisis is not the first of its kind in the last century. There have been many similar periods in recent history, but the seriousness of the current situation is largely due to the increase in trading speed and the diversification of financial instruments. In the future, none of these intensifying factors will disappear and will not diminish its importance. For this reason it is all the more important to exercise good control over the system while avoiding choking it. Finding this balance is one of the greatest challenges of the present century.

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