The 2007-08 financial crisis affected many countries simultaneously and led to a global economic crisis unseen since the Great Depression. It was triggered by a proliferation of financial products linked to risky mortgage loans. The crisis seriously called into question financial globalisation, which to a certain extent amplified risks linked to banking activities and financial markets and brought about financial imbalances among leading economic powers. The question of what rules should apply to global financial activity is crucial in channelling the risks inherent to globalisation.
The 2008 financial crisis – A crisis of globalisation?
By way of introduction...

“For the moment, we’re sticking together, but who knows how long that will last?” Arnaud Lemoine, 35, an engineer at Renault, summarises the state of mind of many Renault employees – both manual workers and executives – in April 2009. During a management meeting, Arnaud learns that in order to maintain jobs during the economic turmoil arising from the financial crisis, employees earning in excess of a given salary are encouraged to reduce their working hours – which also implies reduced wages. “It’s not catastrophic. I still have work... But it still feels strange.”

That same month before the “Arab spring”, Ali El Awary, 43, the owner of a narghile and oriental crafts shop on El-Mouiz street in old historic Cairo, rails against his bank. “I wanted to diversify by opening a restaurant near Zamalek. When I mentioned the project to my banker about six months ago, he was enthusiastic. But since the crisis, banks no longer want to extend credit.” To top it all off, with a drop in tourism because of the crisis, his turnover dropped 35% in 2009. “That doesn’t help me put over the case for my project to the bankers. They speculated, they failed, and now they’re making us pay the price for their fall.”

Reality has been even worse for others. Ratry Sovath, 37, a skilled manual worker living on the outskirts of Phnom Penh in Cambodia, was laid off along with over 50 colleagues following the economic difficulties of the textile plant where she’d worked for over 10 years. “The director told us that orders had halved in six months. With three children, all we have left is my husband’s construction work salary. Life’s going to get very difficult.”

These three situations in three different regions of the world have a single origin: the financial crisis, which originated in the United States. Surprisingly, it affected most world financial markets almost simultaneously, then turned into an economic crisis in many countries. Recovery has been rocky at best, and has led to questions being raised not only about the financial markets and the behaviour of banks, but also globalisation itself. Until now, it could be said that the imbalances and instability caused by globalisation were the inevitable reverse side of the prosperity brought about by opening borders to trade and capital. The world had already gone through serious financial crises (the 1994 Mexican crisis, the 1997 Asian crisis, the burst of the Internet
bubble in 2000, the 2001 crisis in Argentina) at a quickening pace that paralleled globalisation. But they were always limited to one country, or at worst one region. This crisis seems to have vindicated the most virulent critics of globalisation, by endangering the economy on all five continents. This chapter examines the role that globalisation – in particular financial globalisation – played in the crisis.

From the subprime crisis to the global bank bailouts, or how the proliferation of “exotic” securities paralysed banks around the world

Before explaining how this crisis spread around the world in such a short time, let’s retrace the sequence of events. The causes of the financial crisis are complex. One of them was the excessive debt burden of Western – and especially US – households, particularly in the last decade. Within this context, the crisis was triggered by the proliferation of mortgage loans – the famous subprime loans – granted to low-income households. What was so specific about them? High interest rates and long repayment periods, as they targeted modest households with a relatively high risk of default. In order to attract clients, interest rates were very low at the beginning, then increased significantly after a few years. In the early 2000s, at the height of US growth and confidence in traders, subprime credits were very popular. Nearly six million, mostly low-income US households, were on the receiving end of these loans.

But these subprimes were converted into securities, which were mixed with other secured mortgage loans and traded on the financial markets. This “securitisation” practice presented the triple advantage of being very profitable for banks, reducing their mortgage credit risks and dispersing the risks throughout the financial system. The practice grew exponentially in the past decade, spurred in particular by a range of political measures (see From Crisis to Recovery mentioned at the end of the chapter and in the bibliography). As banks increasingly threw themselves into the race for profitable short-term financial operations, the volume and trading of these securities multiplied.
Because of the way global finance was intertwined, as mentioned in previous chapters, securities linked to subprime loans were accumulated in all the banks and on all the financial markets around the world. The problem came from the fact that many households with subprimes had to default on their loans after a few years, as they could not meet the brutal increase in their monthly repayments. These defaults were amplified by the spike in US interest rates starting in 2004 and by the unexpected fall in real estate prices beginning in 2006. The securities linked to these subprimes quickly lost their value, which is when the complex financial products (which included the securities associated with the subprime loans) showed their truly toxic character. Banks no longer had any confidence in the financial products available on the market and stopped transacting. A gigantic financial paralysis followed, initiated by the interbanking crisis of July 2007. Major banks found themselves totally or nearly bankrupted.

As early as September 2007, Britain’s Northern Rock bank was embroiled in a banking panic as its clients withdrew their savings en masse in just a few days. In 2008, several other struggling financial institutions were purchased by others (like Bear Stearns by JP Morgan Chase in March 2008, supported by the US Federal Reserve), nationalised (like Freddie Mac and Fanny Mae), placed under US Treasury guardianship, or bankrupted. On 15 September 2008, investment bank Lehman Brothers’ bankruptcy petition triggered emergency interventions on the part of governments to spare other institutions the same fate. In fact, their bankruptcy would have had catastrophic repercussions for the entire economy – implied in the expression “too big to fail”, which describes institutions that are so connected to the overall economy that governments can’t allow them to go bankrupt.

Government intervention did not stop the financial crisis from affecting the “real” economy. Cascading bank failures led to a credit shortage, which blocked investment and corporate operations, plunging the world into a deep economic recession – the first to touch so many countries simultaneously.
A risk dispersion partly facilitated by the global interconnection of banks and financial markets

What role did financial globalisation, that is to say international capital movements, play in the crisis? Essentially an indirect one. To understand this, let’s review three phenomena that occurred simultaneously after the 1970s.

The first dates back to the 1970s, when companies increasingly resorted to the financial markets (through stocks, bonds, etc.) to fund their activities. The increasingly important financial markets fed and liquefied the economy. Governments began to favour laissez-faire economic theories and minimal regulation of market operations to optimise resource allocation and promote economic efficacy and growth. This meant that all sorts of economic players were gradually able to trade all kinds of financial products on the various financial markets (see Chapter 4).

At the same time, it became possible to conduct financial transactions on the markets of almost all countries, as governments applied the deregulation theory to both international and national financial operations. Financial borders evaporated. Between 1990 and 2004, total assets held by foreigners more than doubled, from 58% to over 131% of global GDP. Around the world today, one listed company share in four is held by a foreign investor – three times more than in 1990. Financial products have also become more globally mobile, making the risks linked to some products more easily “exportable”. This mobility was enhanced by the major banking developments during this period.

Finally, banks became increasingly “globalised”. First, in the years leading up to the crisis, banks consolidated and internationalised. In the 1990s, governments encouraged domestic institutions to consolidate. Banking giants emerged in several countries and expanded their international activities, sometimes through mergers. In 2000, the British banking consortium HSBC acquired Crédit Commercial de France and imposed itself as the 10th largest global banking consortium in terms of market capitalisation.

Thanks to the generalised decompartmentalisation of financial markets, banks became global players, financing corporate and individual activities worldwide and operating on the world financial
markets. As a result, the value of international banking transactions (individual loans, corporate loans, etc.) soared from 6% of global GDP in 1972 to nearly 40% in the early 2000s. In 2005, the total foreign exposure of major banks amounted to 40% of total assets.

**Financial globalisation occurred in parallel with the rise of risky financial practices.** At the same time as they were conquering the world, banks diversified their activities. To sustain growth and increase revenues, major banks expanded their activities to include all financial transactions, even the most speculative and risky ones. They became multi-specialised groups operating in retail banking and traditional products (corporate and individual loans, bank accounts, etc.) as well as in the financial markets (asset management, advising companies on stock transactions, etc.).

To reduce the risk of stocks and bonds losing value (since securities are characterised by their volatility) and hedge against the risks inherent to financial speculation, banks created increasingly complex financial products and hedging instruments – the infamous derivatives. These types of product (among others) allowed them to sell a portion of the risky subprime securities. “Little by little, bankers morphed from takers and dividers of risk into mere risk brokers”, summarises economist Olivier Pastré. The derivatives market reached dizzying heights. Meanwhile, the banks were taking more and more risks while removing these risks from their balance sheets, as banking rules then allowed them to do. This explains in part why in 2006, half of all US individual loans were granted without any prior income verification.

It can be said that the unprecedented interconnectedness of global banks and financial markets furthered the dispersion of toxic products to banks around the world and aggravated the geographic reach of the crisis. Yet the globalisation of banks and financial markets isn’t in itself the cause of the crisis. In fact, it permitted several decades of global growth by multiplying financing opportunities in the real economy. Another aspect of financial globalisation cultivated the bubble that led to the crisis – imbalances in capital flows between emerging countries and developed countries, which we’ll cover a little later.
Financial globalisation also fostered several decades of global growth

The crisis shouldn’t overshadow the positive effects of opening national borders to capital flows. Without the free movement of capital gradually introduced in the 1970s, foreign investments, corporate loans, and international finance would not have fertilised industry and new economic activities in a growing number of countries. Global liquidity has never been so important and available (see graph, Panel A). This has allowed the most ambitious projects to emerge. Increased cross-border capital flows resulted in a lower cost of capital (the more plentiful the cash, the easier it is to finance projects at least cost), higher investment growth and considerable productivity gains.

This means that financial globalisation has helped contain inflation in Western countries for over 10 years. Some consider this one of its chief merits. International capital flows ensure relatively constant and abundant liquidity, which allows banks to maintain low interest rates. This is what most of the world’s central banks did from the late 1990s onward: interest rates have fallen constantly since 1989 (see graph, Panel B).

Add to this the benefits linked to the globalisation of trade which, as we’ve seen, promoted imports of inexpensive goods from developing countries due to their low-cost labour and economies of scale. This has also contained inflation. As a result, prices for a range of consumer goods have dropped. Clothes cost less than they used to in most European countries. Lower prices for communications, electronic or household goods, mobile telephones and computers have allowed the less affluent to access new technologies, while new applications and services have enriched the consumer landscape and created new jobs. It’s true that prices haven’t dropped in all areas and all countries. Some food products in particular have seen alarming price increases. But overall, prices have remained stable or decreased.

Developing countries particularly benefited from the free movement of capital. As we’ve seen in previous chapters, this is at the core of development in emerging countries, even if they paced the opening of their markets according to their different needs and stages of
8. The 2008 financial crisis – A crisis of globalisation?

From the mid-1990s onward, available global liquidity increased considerably, mainly thanks to financial globalisation. Some believe this led to reduced interest rates and therefore facilitated credit and economic activity. The 2007-08 financial crisis called this model into question by highlighting the imbalances underlying this abundant liquidity.

development. International capital flows allowed these countries to receive vast amounts of FDI and to finance their economic activity. These flows also allowed them to build up vast currency and savings reserves, which in turn gave them some protection to weather the grave crises they went through in the late 1990s.

That said, this financial prudence was also partly to blame for the imbalances that laid the groundwork for the current world crisis. Besides risk contagion throughout the world banking systems, one aspect of financial globalisation is more deeply at fault: imbalances in financial flows among great economic powers. This aspect of financial globalisation is one of the most deep-rooted causes of the financial crisis. The subprimes were just a trigger.

**Excessive borrowing facilitated by imbalanced capital flows between emerging and developed countries**

A closer examination of international capital flows over the last decades shows that the abundantly available liquidity that encouraged borrowing and risky banking practices resulted from a considerable imbalance in financial flows between emerging countries and major Western powers.

As we’ve seen, the financial crisis was triggered by the inability of many US households to repay their mortgage loans, which reduced to zero the value of the associated mortgage-backed securities. The gravity of the financial paralysis that occurred almost simultaneously worldwide can be explained by the dizzying amounts reached by these products and by the opaque covering of securities linked to them. How could these credits and securities reach such heights?

For years, Western and particularly US households borrowed from banks to buy the expensive televisions, cars and homes synonymous with the American way of life, gambling on a constant rise in real estate prices. This borrowing frenzy was facilitated by very low US interest rates over a period of several years. This was partly the intention of the US Federal Reserve (the US central bank) and the US government, which wished to trigger economic recovery
through consumption after the Internet bubble burst in 2001. But the low interest rates were also the “mechanical” result of the influx of capital from emerging countries into the US financial system.

For approximately two decades, the free movement of goods and capital allowed these emerging countries to accumulate considerable (mostly dollar) currency reserves, thanks to their exports, and to invest their gigantic trade surplus in Western economies. Some of these investments consisted of purchases of US Treasury bonds, which were considered particularly stable. This was done mainly through national investment funds (sovereign wealth funds) some of which (as in the United Arab Emirates) are larger than the economies of some developed countries (see graph). Other surpluses were

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**StatLink** [http://dx.doi.org/10.1787/888932780247](http://dx.doi.org/10.1787/888932780247)
invested in the capital of major Western companies. The resulting ample liquidity, both in US government coffers and Western financial markets, helped keep interest rates down, spurring Western households to borrow and accumulate debt beyond the capacities of the financial system.

This led many economists to say that emerging countries financed US household debt for over 20 years. Some see this as a negative consequence of financial globalisation. But is the free movement of capital in question, or is it the fact that this free movement isn’t generalised? This question – which also partly determines how to respond to the crisis – is the subject of debate. (See the conversation with Adrian Blundell-Wignall at the end of the chapter.)

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Rules, yes, but at what level?

“The stresses of globalisation are visible everywhere. Ultimately, if the politicians want the liberal market system to work, they will have to make multilateralism work.”

Philip Stephens, Financial Times, 18 September 2008

Even though financial globalisation has yielded many benefits over the past 20 years, the 2007-08 financial crisis revealed major malfunctions, both in banking activities and financial market operations as well as in the highly imbalanced capital flows between emerging countries and Western countries. The free movement of capital across borders should not necessarily mean a total absence of rules.

A global co-ordination framework to manage banking and financial transactions

Given the gravity of the financial crisis, governments were not content to bail out or provide guarantees to banking institutions teetering on the brink of bankruptcy. They also tried to prevent recurring crises, by addressing the failures of the financial system. To do this, they demonstrated political will, especially with regard to international co-operation. They formulated this will within the framework of the G20, whose emergence as the successor to the G8 and first forum of international co-operation reflects the new political and economic weight of emerging countries.

Following the successive G20 summits (London and Pittsburgh in 2009, Toronto in June 2010 and Seoul in November 2010) a number of measures were taken simultaneously. For example, the United States, the European Union and Japan have all introduced reforms allowing them better control of hedge funds, which contributed to inflating the financial bubble. Other projects have been launched by the G20: bonus limits, bank accounting rules, derivative transaction controls, etc. But they are being implemented in national legislations at varying speeds, with significant differences between countries. Global co-ordination is still fragmented and lacking.

And yet co-ordination is particularly crucial. Financial activity is very largely internationalised. Discrepancies in legislation can reduce the most effective domestic legislation to nothing. This is what motivated the reinforced role of the Financial Stability Forum, renamed
in 2009 the Financial Stability Board (FSB). The FSB, which brings together the financial authorities of 23 countries (including representatives from the central banks and finance ministries, as well as several international and financial organisations) aims to improve international co-operation in the field of regulation, supervision and control.

The Basel Committee, comprising representatives from central banks and supervisory authorities of a number of countries, plays a similar role, but limited to the banking sector. Yet the crisis revealed not only the insufficiency of the “Basel II” regulatory framework established in 2004 to channel banking risks, but also the fact that it exacerbated these risks through its accounting rules. The Basel III protocol, scheduled for implementation early in 2013, lays down rules to solve this conundrum. What’s more, following the financial crisis, the Basel Committee expanded in March and June 2009 to include representatives from 27 countries to further harmonise banking rules.

Some international co-ordination regarding banking and financial regulation is taking place, then, even if the substance and harmonisation of the rules, as well as their application, still need improving.

**Reform the international monetary and financial system to correct imbalances**

Reforms upstream of measures regulating banks and financial markets are going to be needed to resolve the financial imbalances between emerging countries and Western countries, which caused the excessive US household debt. The necessary solutions are still being discussed, but two questions dominate: reforming the international monetary system and managing capital flows.

For many observers, the fact that China and other emerging Asian countries control their currencies (and set their levels) while Western countries let their currencies float against each other (the value of the currency fluctuates according to offer and demand) biases globalisation, since it promotes their exports and exacerbates the trade deficit and household debt of other countries. The solution would be for major emerging countries (including China) to allow their currency more flexibility, in the spirit of the generalised currency floating system characteristic of the post-Bretton Woods era. While the economy is certainly greatly globalised, in some respects it continues to operate at multiple speeds (see the conversation below with Adrian Blundell-Wignall).
The debate on the control of capital flows is more controversial. Some believe that the crisis justifies a return to much stricter government control of capital flows. That’s the fondest wish of economists Jean-Hervé Lorenzi and Olivier Pastré, as stated in a 2008 article in Le Monde newspaper entitled “A New Bretton Woods”. Others believe on the contrary that China, which in addition to controlling its currency also controls capital flows from international markets, has distorted globalisation. For the authors, all countries should fully play the game of free movement, while controlling more strictly some banking and financial market activities (see below).

It’s an open debate, but whatever the outcome, “world governments cannot afford to maintain the status quo”, as OECD Secretary-General Angel Gurría declared repeatedly in the wake of the crisis. Yet these fundamental imbalances are still not resolved, and some see them as major risk factors in any future new global crisis.

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**A conversation**

Adrian Blundell-Wignall, Deputy director, Directorate for Financial and Enterprise Affairs, OECD

"The problem of financial globalisation is that it currently features both rigid and supple elements. Some countries control exchange rates and capital flows. Others allow free markets. This gap engenders structural weaknesses.”

**Some believe the 2008 financial crisis is the first truly global crisis. Is globalisation responsible for this crisis?**

Distortions at the level of global regulation, not the globalised markets, are the main cause of the crisis. But the globalisation process was not undertaken in a sufficiently balanced manner.

**Meaning?**

Imagine a dam above a village. The reservoir fills with water. But the walls of the dam are badly constructed. They have weaknesses. When the water pressure becomes too high, the dam gives way at these more fragile areas. The water ends up destroying everything. The rising water is the prosperity generated by globalisation. The defective walls are the regulatory frameworks on several levels. The problem of financial globalisation is that to this day, it features both rigid and supple elements: some countries control exchange rates and capital flows, while others allow free markets. This gap engenders structural weaknesses.

**Why is there such a gap?**

In 1973, when developed economies instituted a floating currency exchange system, a country like China weighed less, economically, than Australia. While Beijing maintained a fixed exchange rate system for its currency, this was relatively insignificant to the world economy. But in the meantime, some of these countries began to industrialise. Their economic weight is now greater than that of the United States. Under these conditions, Beijing’s fixed exchange rate throws the world economy completely off balance. These past years, the Yuan has been dangerously under-evaluated. The US trade deficit compared with China has worsened for that reason. In addition, thanks to their fixed-rate system, some Asian and Middle Eastern countries have been able to accumulate enormous financial reserves. They have recycled liquidity in the very open US economy. The influx of liquidity pushed US interest rates down and inflated the real estate bubble. The United States had only two possible choices: allow the trade deficit to deepen, or increase interest rates. But this latter option would have meant entering wilfully into a recession.
A conversation

No government wants to do that. So the US deficit continued to widen, compared with emerging countries.

**China isn’t solely responsible for this imbalance – or is it?**

Alan Greenspan, the previous president of the Federal Reserve Bank, found a convenient justification for his lax monetary policy. He spoke of a productive revolution. For him, a new era had opened with the advent of globalisation and Asian industrialisation. We were massively importing Chinese products. It was the WalMart effect [Wal-Mart is the largest US distribution chain, renowned for its very competitive pricing]. The US market was open. Inflation was contained. But all that was set up at the price on the one hand, of a gigantic trade deficit and on the other hand, of an astronomic hike in financial asset prices. It was more comfortable to believe in the productive revolution, but economic laws are what they are. Clearly, Alan Greenspan was wrong.

**Should China have been forced to comply with the same rules as other countries in terms of opening its capital market?**

Emerging countries should have been associated more with the decisions of the major international economic institutions. For example, they should have obtained the same number of votes at the International Monetary Fund (IMF). In the end, Western countries should have implemented better regulation and better governance that did not create distortion. At the same time, we should have included emerging economies in the decision-making apparatus of the global financial system. Of course, that entailed giving up something, but in my opinion that was the way to go.

**During the Asian and Russian crises of the 1990s, shareholders withdrew capital very suddenly. Many blame the IMF for encouraging developing countries to liberalise their capital market too soon. Didn’t China, India and a few others do the right thing by locking their systems?**

Free trade provides some prosperity, but there is a price to pay. When a country’s trade surplus translates into deficits among its trading partners, these deficits must be financed. That’s when free movement of capital is required. The impact of FDI on Chinese growth will gradually decrease, as happened in Japan and Western Europe after a period of very strong growth in the 1950s and 1960s. When that stops, you wonder what to do. The industrialisation phase ends and you have to invent something else. That’s when you need to open your financial markets, to fuel economic innovation. China will probably not be able to escape this. But China controls capital flows and the value of its currency. Foreigners cannot buy Chinese companies or invest freely in the stock market. If the United States used the same method to stop Chinese operators from buying US assets and converting their yen into dollars, China could no longer sell anything anywhere. Ultimately, this isn’t an option.

**As soon as a problem crops up in one area of the system, it contaminates the entire system in a split second. Isn’t that the problem of financial globalisation today?**

I don’t agree. It’s as if you said that to fight an epidemic of bird flu, you have to remove the air around us, because it transmits the virus. If you have a major solvency crisis in an institution that is present around the world, will it have repercussions on the rest of the system? Of course. But globalisation isn’t the cause of the problems. Their root is this generalised insolvency.

**Shouldn’t we provide security systems to avoid problems spreading throughout the financial world? Like ships, which have airtight compartments...**

If we had sensible fiscal and macroeconomic policies, opening financial markets would contribute to global prosperity. To go back to the ship analogy, it’s better to have a good radar system and a good navigator.

**If globalisation isn’t responsible, what do you believe were the causes of the systemic crisis in 2008?**

It’s a combination of factors. First, the banks changed the economic model. In the past, they took deposits and accumulated them in their accounting balances. They added a bit of capital to that and then lent money. Banks were like paternalist enterprises; they were not caught up in a logic of strong growth at any cost.
8. The 2008 financial crisis – A crisis of globalisation?

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| But towards 1995, stock valuation began to be more important than the rest. Managers started receiving very large bonuses – *stock options* – based on enhanced shareholder value. They had to boost return on investment. Banks then expanded their activities as investment banks. In the 1990s, intense lobbying succeeded in allowing major banks to develop this kind of activity, which has the advantage of not being subject to prudential capital controls [rules that aim to minimise a bank's risk of insolvency]. Keeping to those rules is expensive. For the banks, that cost equates to a tax. Freed of that cost, they were able to carry out increasingly profitable, but increasingly risky activities. The problem came from these highly risky and volatile investment banking activities.

Consider the domino effect on the banks first hit by the 2008 financial crisis. It all began with the investment bank Bear Stearns, followed by Lehman Brothers, Merrill Lynch, Citigroup and UBS. Finally, AIG, an insurance company, was dragged down by its subsidiary, a London investment bank. In each case, the fall was the consequence of the banks’ changed economic model and the intensification of their investment banking activities.

**You said that the problems resulted from defective regulation and economic policies. Why didn’t we predict the excesses that undermined the banks’ activities?**

The major US banks used to earn a living selling mortgages to two institutions supported by the US government, Fanny Mae and Freddie Mac. But in 2004, the US regulatory agency limited their capacity to respond. Investment banks played a major role in transforming mortgage assets into investment products that they could then sell to third parties. But they did so in the context of the “American dream”, which was supposed to allow all Americans – even the poorest – to own their own home. The products were toxic. So much for failed economic policies.

In 2004, the Basel Committee on Banking Supervision, which sets banking supervisory rules worldwide, voted for the new “Basel II” arsenal of solvency rules. These rules will probably be the shortest-lived regulatory framework in history. Their goal was to make banks more solvent, but they had the opposite effect. Basel II prompted some banks to reduce their capital in order to increase their yield per share. In addition, regulation encouraged them to take more risks. At a certain point, the crash becomes inevitable and contagion spreads to the rest of the world economy. But again, the problem isn’t the air we breathe. The problem comes from the infected chicken coop.

**What aspects of the financial globalisation process should be corrected?**

Clearly, we need international co-ordination. There’s a need and a place for a flow of aid and loans to developing countries. Global co-ordination requires inclusiveness, with an equal number of votes for all.

The globalisation process has been too imbalanced. We can’t continue to export and tap into the resources made available by global capital markets without accepting that this is a two-way process. All the economic actors must follow the same rules. That said, I think the global financial system today needs to be more flexible. It should certainly not go back to market protectionism.

**So you’re not in favour of a stricter supervision of capital flows worldwide?**

No. The Bretton Woods model isn’t a panacea. In the 1970s, the prices set by the Organization of Petroleum Exporting Countries (OPEC) tripled, which caused a major crisis. The Bundesbank did not wake up one day in 1973 believing that we should let exchange rates float. Germany was losing gold to the United States. There was the Viet Nam war to be financed, etc. The world has always experienced shocks; they did not suddenly arise from globalisation and the free movement of global capital. At the time of the OPEC crisis, there was this strict framework which some still dream of today. The result was that we had 10 years of negative stock returns and massive inflation. People who had fixed-interest investments saw their capital evaporate in three or four years because inflation reached 20%. They lost some of their retirement savings. The Bundesbank did not help to stop Bretton Woods through some sort of ideal, but because it had no choice. The lack of flexibility made the framework economically unviable. Without flexibility, the system can’t be robust to shocks.
Find out more

FROM OECD...

On the Internet
OECD work on the financial markets is available at www.oecd.org/finance.

Publications
Financial Markets Trends: This half-yearly publication offers regular updates on the trends and perspectives of the major international financial markets and the main financial markets of the OECD and beyond. See www.oecd.org/daf/fmt (in English only).

From Crisis to Recovery: This OECD Insights analyses the roots of the 2007/08 crisis and describes how it contaminated the real economy and how the repercussions of the Great Recession will continue to be felt in years to come.

... AND OTHER SOURCES

Des subprimes à la récession: Comprendre la crise (From Subprimes to Recession: Understanding the Crisis) (2009): This simple and clear work published by La Documentation française and France info explains the various stages of the crisis, its practical repercussions on households and companies, and the actions of central banks and governments. It also covers the aftermath of the crisis and the reforms required to avoid a recurrence.

Malaise dans la mondialisation (Malaise in Globalisation), Questions internationales, No. 34, November-December 2008: This publication from La Documentation française features clear and in-depth analyses of matters related to the crisis and financial globalisation, such as the transformations of the international monetary system since the 19th century, the subprime crisis and its consequences, the integration of stock markets, the growing role of financial markets in the world economy, whitewashing and international financial crime, and the internationalisation of public debt. The articles are written by economists (such as Jean-Hervé Lorenzi, Olivier Pastré and Dominique Plihon), as well as analysts and experts from banks (such as BNP Paribas) and public organisations (such as the Financial Action Task Force).

Alternatives économiques : Spécial crise (Economic Alternatives: Special Crisis Issue), No. 274, November 2008: In this special issue of the economic monthly magazine, economists Michel Aglietta, Christian Chavagneux and Sandra Moatti explain some triggers of the crisis, such as the “debt machine”, the government bailouts of the major banks, the financial regulation projects and the crisis of an unequal growth model.

On the Internet
The USD 1.4 Trillion Question: In this Atlantic Online article written in the early stages of the crisis in January 2008, economist and former White House economic adviser James Fallows explains very clearly the mechanisms through which China massively invests the surplus derived from its trade surpluses in the United States, thus contributing to the dangerously high debt of US households. www.theatlantic.com/magazine/archive/2008/01/the-14-trillion-question/6582.