

# Martin Wolf Fixing Global Finance

fin crisis largely abroad in 50s + 60s

"The United States has become the world's spender and borrower of last resort, ... because the world of globalized finance has proved so unstable" XIV

## Ch 1 Learning Lesson

"Finance is the brain of the market economy" ... Unfortunately, as the world has been reminded too frequently over the past three decades ... this brain is susceptible to a variety of infirmities. In particular, it is prone to wild swings in mood, from euphoria to panic" p 1

biggest economic challenge to those who support globalization

"Even in the mid-1980s, few economists understood the potential for disaster in the interplay between liberalized finance, global financial integration, and the international monetary system" p 2

Japan crisis in 90s closest to people's domestic

"In the 1970s, 1980s, and 1990s financial crises always followed periods of large-scale net capital flows into emerging market economies" p 3

Now "Emerging market economies smoke, but do not inhale" in global capital markets. The majority are prepared to engage in capital markets, but do not accept... net capital inflow into their economies" p 3

"A large-scale flow of capital from poor countries to the world's richest nations is perverse" p 4

"The macroeconomic question is how adjustment of the global balance of payments might occur" p 4

"Finance rests on promises - which, by their nature, can be broken" p 5

He thinks that Bernanke was fundamentally right about savings glut  
 $\approx 1/6$  of S of ROW

" that real interest rates were so low strongly suggests that ... low spending elsewhere was crowding in U.S. spending and external deficits" p8

both private & govt decisions  
If U.S. had refused to accept  
C.A. deficit " the U.S. economy  
would have been stuck in recession  
and the rest of the world would  
have suffered economically as  
well " p8

questions of global adjustment and reform

" reform must address exchange rate, monetary, and fiscal regimes; the regulation of the financial sector, legal institutions and the protection of property rights "

The aim is to create a combination of micro - and macroeconomic conditions in which large flows of capital from abroad become relatively safe" p7

failure to understand a wide range of risks

Ch 2 Blessings and Perils of  
Liberal Finance

"Everybody Loves To Hate Finance" p12

end 05<sup>-</sup> US households + NPOs  
 64t A 12t L  
 net 52E 5x GDP  
 tangible 25.6  
 fin 38.7

Fin A	E 30	
J	19.5	
UK	8	
US	38.7	80% of global
3x 4 05		140E
2.18 95		
1.07 80		

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stocks	44t	
private debt	<del>23</del> 35	
govt	"	23
bank deposits	38	- from 42% in 80 to 27% in 05

"Sophisticated and dynamic modern economies depend on pyramids of promises far more impressive and complex than those of stone constructed by the pharaohs... yet the confidences that sustain them could all too easily prove misplaced" p 12

- Black Swan
- asymmetric information
- adverse selection
- moral hazard
- rational ignorance
- crony capitalism
- holding hostages - collateral
- self finance
- markets transformation

"The essential role of government is to supply the institutions that create and sustain trust in financial promises" p 16

"Good government is... the foundation of any sophisticated financial system" p 18

"The impact of panic on the stability of a fractional-reserve banking system" 19

"Financial crises are as old as capitalism itself"

Two polar views  
irresponsible private sector  
or incompetent govt reg

the impact of globalization on financial  
is both beneficial  
& perilous

"There appears to be thresholds of institutional quality above which financial liberalization is conducive to growth and below which it is harmful" p 24

"foreign direct investment and other non-debt creating forms of capital flow... seem to be substantially more beneficial and substantially less crisis prone than debt flow" 24-5

p 25 contagion

"At its most basic, panic is the cause of flight to safety by investors who know they do not know the riskiness of the assets they own" 25

Int transactions inherently more crisis prone

"Trust in promises made by foreigners is likely to be weaker than trust in promises made by fellow citizens" 28

"Governments are always partner-  
shipped or open - in international  
financial transactions" p 28

Woj

W8

" Prior to the late 1970s,  
most economists who were interested  
in international macroeconomics  
thought relatively little about  
finance, while most economists  
who were interested in finance  
knew little about international  
macroeconomics." p 32