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NEW ORDER ON GLOBAL FINANCIAL MARKET: POST-CRISIS PROJECTS AND REALITIES

Abstract

The present paper is concerned with the problems of a new financial order formation on global financial markets after the world economic crisis of 2007–2009, the reasons are systematized that hinder the proper reformation of the financial system in the context of reaching the higher degree of its functioning transparency and renewal of market participants confidence.

Key words:

New global financial market, derivatives, regulators, financial crisis, interstate regulation.

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Relevance of the Topic and Definition of the Problem

In the periods of enormous shocks scientists and practical experts use to re-estimate their activities, primarily theoretical concepts which had been considered as basic ones in the pre-crisis period. They search among theoreticians and practical experts for those who are considered to be guilty, and determine the ways of surmounting the crisis phenomena in global economy. The world economic crisis of 2007-2009 has not become an exception either.

For that period, as a result of continuous discussions the reasons that had triggered the crisis were formulated, and the proposals offered as for the formation of a new order on the global financial market. This problem has been actively researched by Noble prize winners J. Stiglitz, P. Krugman, economists N. Rubini and M. Khazin, who forecast the crises long ago, also the richest investors W. Buffet and G. Soros, our national researches V. Heiets, A. Halchynskiy, O. Baranovskiy, M. Syvulskiy, V. Mishchenko, O. Dziubliuk, O. Vovchak, I. Lunina, and others.

The leading politicians and governments of the world countries actively integrated into that process, who with their common efforts try to stop the decrease of global demand, renew crediting, and liquidate imbalances in the development of world economy. So far, we can admit that mainly the diagnoses are right. Nevertheless, the prescriptions of the crisis surmounting and formation of a new global economic order under condition of which the financial component would not dominate over the real productive activity in the world economy, are offered to be of several stages, i.e. from the projects of international cooperation to taking into account the peculiarities of each individual country. On the way towards development of new rules for the global financial market functioning, still enormous challenges are observed, in particular, those of a hidden nature. The objective of this paper is to show principal outlines of a new global financial order and the barriers on the way of its development.

Statement of the Topic Examined

Among the main reasons of economic crisis most of the researches distinguish unsteadiness of financial markets conditioned by uncontrolled explosive trading in financial derivatives. The analysis of printed publications and those placed in Internet for the last two years showed, that the eminent economists did not respond for a long time to the 2007 mortgage crises in the USA; either they did not pay great attention to that event, while the economic observers of the leading economic sources, and politicians overreacted.

Thus, that problem was one of the urgent topics (alongside with global warming and the development of China and India) of debates at Davos Business Forum in 2007. Angela Merkel, who presided G8 in 2007, declared: «We want to minimize the system risks on global markets of capital and improve their transparency. The threat of enormous market crisis caused by financial derivatives ousts the threat caused by low rates of interest, which leads to increase of financial fragility» [1]. David Wessel, a popular Wall Street Journal observer named three «R»s that are considered to be mainly to blame, meaning *rocket scientists, regulators and rating agencies.* For *rockets* he implied the Wall Street financiers who invented structural (synthetic and hybrid) financial instruments and technology of their security, and which instead of redistribution of credit risks made even deeper debt pit for investors [2].

Another American journalist F. William Engdahl, who is not less famous than the named one, like the present-day chief of Federal Reserve System Ben Bernanke, the graduate from Princeton University who has been living in Germany for the latest decade, reasonably considers that even during the acute financial crisis, that he calls a financial tsunami, the leading economic journals are not interested in publication of revolutionary scientific views, otherwise the careers and the whole academic professions would be set on a chance.

He casts doubt on the basic financial theories, like disgraced economist B. Mandelbrot and known investor G. Soros did for a long time, specifically, the theory of market information effectiveness, random walk theory of prices and interest rates, on the basis of which the theories of portfolio investment and risk management had been developed. These theories could be applied to the markets when the prices fluctuate in minor ranges, but in crisis period they are not effective. His conclusions, from my point of view, is too categorical, saying: «Theory, that can not explain the sudden events, in spite of all Noble prizes, does not deserve even the paper on which it is written» [3].

According to B. Mandelbrot, who is considered among economic academic community an original man, «the old financial orthodoxy is based on two key hypotheses of L. Bachelieu model (French mathematician, who in 1900 defended his Doctoral Thesis, dedicated to speculations on financial markets), i. e. price changes is statically independent and normally distributed… Most of changes (68%) is an imperceptible movements up and down within a single standard deviation (the mathematicians call the simple criterion of data deviation from the average). The two standard deviations range encompasses 95%, and three – 98%. And finally, very little number of significant changes could be expected [4].

In that work and in many previous ones B. Mandelbrot on the basis of the analysis of financial markets behavior in crisis periods ascertains the fallaciousness of that basis of modern financial theory, the development of which had been rewarded with tens of Noble prizes, and what is the worst, in his opinion, that it is just that theory which is studied in the leading world Universities and implemented by the financiers from Wall Street and London City. He justly notes that investors are not rational; markets can not be described through random processes, since the tools applied for describing the phenomena of wild-life against the classic physics are required.

Only 2009 became the year of the economic theories re-thinking by most scientists throughout the world countries. In particular, heat discussions arose around the article of 2008 Noble prize winner Paul Krugman «How did Economists Gets it so Wrong?» published in New York Times on 2September 2009. In that article he puts in question the basic economic theories, ascertaining that the abstract models consisting of sophisticated mathematic apparatus do not correspond to life realities, and moreover, are harmful to some of them [5].

Those ideas found its reflection in the depth-in report «Global Economic Crisis: System Dislocation and Multilateral Ways of Surmounting» of 18 March 2009, where a very important generalization was made, that the market fundamentalism of free competition for the latest twenty years had not stood the trials. The crisis behavior reflects significant problems of national and international regulatory instruments, steady global imbalances, absence of international currency system, and deep inconsistencies between global trade, financial, and monetary policies [6].

That report was developed by the UNCTAD target group in system questions and economic cooperation, headed by the Director of the Department of Globalization and Development that had been committed to study the system aspects of the crisis and to develop the proposals for the formation of new policy of national and international scales. That document is concerned with urgent necessity of coordinated actions respectively the formation of a new world economic order, providing for global cooperation and global regulation.

The global and systemic character of this crisis has humbled the regulators, market participants, and scientists into shock. Non-ordinariness of the situation consolidated the leaders of twenty countries (G20), who after their 2009 September Summit in Pittsburg (USA) decided to make those meetings regular to develop and coordinate actions concerning the formation of a new economic and financial order [7].

Having systematized the proposals of scientists, and the agreements of the G20 leaders, the project for the formation of a financial order on national and international levels provides for the following:

- the priority tasks concerning the arrest of price downward movement for security assets and consumer demand, renewal of production investments crediting, priming of economic growth, and preventing the price deflation could be reached specifically through the reformation of financial markets regulation, consisting in systematic withdrawing of financial innovations that are socially inefficient. New financial instruments in many aspects weakened the abilities of financial organizations to manage risks; they also promoted the creation of non-transparent, poorly regulated and undercapitalized shadow financial system. Therefore, these instruments issue should undergo the procedure of licensing by regulatory bodies, who are obliged to monitor the outcomes of their application;

- the systematic failures of the illusions on financial markets with respect to getting profits without risks can be overcome specifically through joint efforts of the states. Profit seeking of many economic agents should be stopped, who try to get profit measured in two-digit (and in Ukraine in three-digit) numbers in economic system where the increment of growth makes several percents. «A good policy should envisage that people are mammonish and small-minded»,- is justly noted in the named UNCTAD report. The regulatory organs of the states can do it, through monitoring the market situations, following the price behavior and taking the proper measures where there arise great imbalances:
- to evening-out the negative effect produced by powerful financial investors on the markets of commodity futures (oil, grain, metals, etc.) the regulating organs should have the access to information on making the exchange deals, and alongside with that to adjust the regulation of non-exchange markets, primarily respectively the fixation of deals with derivative instruments and their hybrid and synthetic combinations in financial statements, and introduce transparent rules of payments (clearing) within those agreements similar to exchange ones;
- to improve the international stability, fundamental reformation is proposed for monetary and financial system, in particular, introduction of management for flexible exchange rates oriented at real exchange rate agreed with the sustained current transactions statement of accounts. It would allow to minimize the speculative trading, since just the difference in inflation and interest rates enables to do that, and that, in its turn, would decrease the necessity to create the international reserves for securing the exchange rates, and could support the role of special drawing rights, if their distribution would meet the needs of this or that country in international liquidity for stabilization of its real exchange rate on a fixed level.

The G20 leaders, in particular, agreed to jointly estimate (assess) their economic plans, to reach consensus concerning the advanced practices of reforms implementation, and in joint efforts take political decisions to support the required balance renewal of world demand in order to provide sustained economic growth. The G20 leaders (from this time on it is a standing body of international cooperation) have reached agreements on introduction of rigid standards of banking capital, compensations directed at stopping the practice leading to excess risks.

Also, understanding had been reached in the area of kerb derivatives trading regulation and procedures of managing bankruptcy of global financial organizations. In addition, the agreed decision was taken on the transparency improvement of oil futures exchange market through introduction of comprehensive statement on crude-oil production, its utility and preservation.

Great job in this respect has been done in the European Union. The EU authority considers, that nowadays the financial markets of the EU member countries are not only national, but also European and global. From that view, the control over them should be both, European and global.

The packet of financial bills, suggested by the European Commission, provides for rapid and critical actions directed at clearing faults of the system of the European financial control that would prevent the probable financial crises.

Reformation of financial system of the European Union provides for eliminating drawbacks on macro-and micro-levels of prudent supervision through establishment of new all-European organs, in particular, the European Systemic Risk Board – ESRB, and the European System of Financial Supervisors – ESFS.

The European Systemic Risk Board is a body of macro-prudent supervision (supervision over the EU financial system as a whole). It will monitor and risk rate to keep (support) the financial system stability on macro-level.

The ESRB will notify on the systemic risks in early stages of their occurrence, and in case of necessity will recommend the actions to both, all-European and national state regulators on fighting the risks.

The European Systemic Risk Board will include the Director of the European Central Bank (ECB), managers of Central Banks of the EU member countries, all-European Supervisory bodies, as well as national regulators of financial markets.

In its turn, the European System of Financial Supervisors has to be a body of micro-prudent supervision (supervision of certain financial institutions). It will include state regulators of the EU member countries financial markets that work in tandem with the new all-European supervision bodies, which had been created through transformation of available securities committees in banking sector, as well as those of insurance and pension sectors.

As a result, the European Securities and Markets Authority – ESMA, the European Banking Authority – EBA, and the European Insurance and Occupational Pensions Authority – EIOPA would be created.

It is worth noting, that at the moment there are three Financial Committees, which have been carrying out the micro-prudent supervision in the EU level specifically with consulting authorities. In particular, they include the following: Committee of European Securities Regulators – CESR, European Banking Supervisors – CEBS, Committee of European Insurance and Occupational Pensions Committee – CEIOPS.

The new organizations will undertake all functions of those Committees. In addition, they will be assigned the additional authorities, including the following:

- development of proposals on technical standards using the principles of effective regulation;
- adjustment of inconsistencies among national regulators and making their cooperation closer;
- promotion of step by step implementation of a new legislation (including that made through expertise);
- coordination of regulators' work in force major situations.

At that, the European Securities and Markets Authority will supervise the Credit Rating Agencies.

To ensure the effective work of the European system of financial supervision the proper norms, like the EU directives, will be provided for the organ's authorities.

In particular, certain areas are to be determined where the technical standards should be offered as an extra instrument for generalization of supervision and development of the unique list of rules.

The substantial point is to adjust the inconsistencies between national organs of financial control on balanced basis and to ensure their effective interrelation within the frame of the new system of supervision and control. The legislative amendments should also provide for the mechanisms for transformation of the Bank Securities Committees, likewise the Insurance and Pension Committees into new supervision organs. The European Commission is planning to make a series of proposals to the developed projects by next year. The new system of the European Union financial market regulation is planned to be created by the end of 2010.

Nevertheless, it is not easy to reach the agreements on the named problems. So far, we can state, that the concrete results (practices) of the sciences and most of G20 leaders concerning regulation level improvement is badly accepted by big business, specifically by investment banks and other financial institutions, and that does not allow the projects to become realities.

For the period from summer 2007 to autumn 2009 the mass media sources and Internet placed a great many of articles, interviews with well-known economists, in particular, the Noble prize winners, also leaders of different countries, observers of leading economic sources, authorities of international organizations with respect to those problems.

Every world country has made its specific groups of scientists who detect the reasons of actual crisis and develop the recommendations for the leaders of their countries. Thus, in the USA at the Council of International Relations a working group of scientists from the leading Universities was made who in July 2009 promulgated their recommendations concerning the formation of new rules of financial markets regulation, accentuating the most problematic innovations, i. e. credit default swaps [7].

The essence of those recommendations implies the idea that had been discussed for a long time by market participants and regulators, in particular, the following: introduction of the rules of exchange trading into over-the–counter markets, primarily in the item of clearing when concluding and consummating agreements, and making the financial statements more transparent. However, for the latest decade the former Chairman of Federal Reserve System Alan Greenspan had been doing his best to hinder that. And today (December 2009) under another Chairman Ben Bernanke still there has been done nothing but the recommendations.

The essential changes in the world economy, in this author's opinion, were described not by economist, but by the laureate of international pianists competitions O. Botvinov [8], who in his thorough article published in «Mirror Weekly» newspaper (June 2009) justly noted that the bankruptcy and nationalization of automobile giant General Motors is not only the crash of American market model, but, no more or less, the completion of the epoch as a whole. And it refers not only to the epoch of American way of life, but to the global one, implying the epoch of market self-regulation as a senior judge of American society.

The known phrase «what is good for GM is good for the USA» for a long time reflected the state of play in American economy. With GM bankruptcy the corporation that for one hundred and one year period was not only a flagship of the USA industry, but the central cultural symbol as a whole, had been dissolved.

In 2008 only some months were needed to make it clear that capitalism in the format it had been existing for over two hundred years and ensured progress for at least the countries of «gold billion» and increase of their life standards, at the moment can not meet modern challenges. We can agree with the thesis of the above named author that it will be the globalization as the main instrument for promoting the interests of transnational corporations which will cease their excessive profits.

Primarily, it refers to big Wall Street, London City and Europe's investment banks. These financial institutions have become insomuch powerful for the latest decade that their activities were called ***financial production.*** The Harvard and Stanford University graduates, specifically mathematicians and physicists, who used to become the known financial engineers, in professional jargon called ***quants*** and whose wages and bonuses made six-seven-digit numbers of dollars, tried to be employed in the named financial institutions.

They introduced innovation financial instruments, strategies and technologies, known to no one but themselves. Moreover, that activity was almost not regulated by state organs. In that way there were introduced over- the- counters credit derivatives, securitization technologies, financial software provision, that, in its turn, created the conditions for explosive-wise development of that area.

The Chairman of Financial Services Authority Lord Adair Turner in his recent interview (September 2009) to the known Internet title said that the management of complicated modern economy needs different (other)macro-control leverages of financial security, and in order to prevent a new credit bubble in 2015–2020 it is necessary to introduce rigid demands to liquidity and capital. During recession the weak banking system is sure not to become the additional factor enhancing the recession. He regards that meeting those challenges requires a large-scale structural transformation of the global system of financial supervision, since minor changes would fail to reach positive developments. Nevertheless, it is worth minding, that it is impossible to completely avoid economic cycles, and if one hopes to do so, he is self-deceiving [9].

A. Turner's point of view coincides with that of the author of the UNO report on financial innovations, who thinks it necessary to introduce a rigid state control over financial market participants as for detecting the instruments that do not facilitate the creation of added value and do not produce social effects.

The Central European Bank also takes the research problems seriously of that area on global financial market. In August 2009 the work group of that institution promulgated the findings of their research under the title «Credit Default Swaps and Counterparty Risk», where for the first time the relation was shown so deeply and comprehensively between the use of over-the-counter derivatives by the investment banks who stopped trusting each other and did not count for the counterparties risks [10].

Since regulators could not control over-the-counter market of financial innovations, there were many irregularities. Uncontrolled use of sophisticated structured products did not decrease, but on the contrary increased transactions risks. Margin trading, large credit shoulder in all operations without exception, «short selling»[1] shares system that not only distorted their market exchange rates, but also made the corporate management more complicated – these are some of the problems of financial markets requiring urgent solution.

In author's opinion, it will be the most difficult to reach the financial order when the profits of financial market participants would be comparable with the increment of economic growth. The challenging solution of that problem lies in the fact that wages and bonuses of top-managers of investment banks, hedge funds, and insurance companies were measured in astronomical figures, and those were also that high in the institutions that had been saved from bankruptcy by the state.

[1] «Short selling» is selling of borrowed shares to be returned to their owner in a certain term. Usually, it is a speculative deal made with the aim of yielding profit through falling share price enabling to sell more expensive, and then to buy cheaper and return them to their owner.

Only a very rigid and principle position of French and German leaders allowed to start resolving that problem at the G20 Summit in Pittsburg. The USA and Great Britain were against bonus limiting to managers and their position could be simply explained by the fact that the political elite of these countries is represented by former bankers.

It was like that from the very beginning of the Federal Reserve System establishment in the USA. The FRS is a private bank established in 1913. Its founders are the biggest investment banks of nowadays, like Citibank, JP Morgan, Goldman Sachs, and Depository Trust Company. These banks sustained great losses amid the crisis of 2007-2009 (they were heavily criticized because of uncontrolled application of the financial engineering tools), and it is these banks who are staffing the high governmental positions of the USA. The Depository Trust Company – a monopolist, that holds on deposit over 2.5 mln. of American and non-American shares, corporate and municipal debt securities from over 36 trln. dollars, also has a significant influence regulators bodies. Annually, the agreements on securities of over 1.5 quadrillion value are concluded here. The establishment of that powerful FRS at the beginning of the 20th century fostered (promoted) the substitution of English pound having the ratio of silver, and later- of gold not changed from 1561 to 1931, with the USA dollar [11].

In the cold war period the USA's implicit threat to deprive the European countries and Japan the nuclear shield, enabled these countries' Ministries of Finance to purchase the American Treasury bonds. And it was at that time when the securities markets became the biggest in the world. Gradually the dealers of primary placement of treasury securities (investment Wall Street banks, stock jobbers) became more important than Pittsburg steelworkers and Detroit motorists representing «a true American business» (p. 38).

The paraphrased known words said by the former General Motors President Charles Wilston sound as a new mantra «What is good for Wall Street is good for America».

In fact, there is not much good here. The phrase «financial production» became common when money was taken for a legal successor of the production of a real physical wealth in economy [12]. That period demanded the financiers who were able to create, develop new instruments, funding models, high rate risks insurance in order to increase in perspective business worth.

About 1991 the term **financial engineering** came into being, implying the development and creative application of financial technologies for meeting financial problems and employment of financial opportunities.

That process did not cease in the middle of 2009 when the financial engineering was strongly criticized. At the moment the investment and commercial banks, which had not yet completely recovered after the crisis, invite the primary goods traders and employ them with one mln. bonus incentives for increasing the number and volume of transactions with commodity derivatives. The commodity assets of American banks grew for the second quarter of 2009 by 19%

up to 209 bln. dollars. Bank of America Corp. hopes to expand the staff of commodity analysts and traders for the nearest 2–3 years by 25%. These changes are connected with the increased prices for the following primary goods: oil, copper, grain under condition of price fall for security assets, real property assets, etc. [13].

The scientists and the UNO officers also warn about that threat, pointing out the negative outcomes of channeling significant funds to the markets of commodity futures (everyone remembers the oil price making 147 dollars per barrel, and nowadays gold price in 1 100 dollars per troy ounce, etc).

However, the Goldman Sachs Bank and eleven banks more so far have the right, that they were granted in 1996, to conclude hedge contracts on primary goods (prior that time, from 1936 specifically producers and primary goods manufacturers could become hedgers, while financial institutions and physical persons had the right to open a certain number of speculative contracts enabling to separate sellers and buyers of real goods from those who traded virtual). As it was shown above, other banks follow that example, that is, in spite of the projects of creating a new financial order prohibiting that activity, the nowadays realities are just of that kind.

Thus, for the latest seven years the greatest world financial players on credit derivatives markets Goldman Sachs, Morgan Stanley, HSBC, JP Morgan Chase, Deutsche Bank's earnings were so impressive that nothing has been done to reveal the risk models applied by the mortgage «wraparound» experts (p. 41).

Recent publications in foreign press corroborate that even today, despite the international agreements, JP Morgan Chase in the third quarter of 2009 earned so much money that he pays enormous bonuses to his managers. London Evening Standard paper writes that 5500 London employees of Goldman Sachs could get 500 000 pounds bonuses each. Top managers receive bonuses making several million, and the largest wages are about 10 mln. pounds. Paul Roberts' article about these facts has a speaking title «The Rich have Stolen Economy». It shows that the bankers receive the sky high incomes at the background of rapid pauperization of middle class, increase of unemployment, etc. [14].

On November 2009 the Goldman Sachs President Lloyd C.Blankfein through The New York Times paper apologized before the world community for the financial crisis ignited by the bank felony, and promised to fund five million dollars annually as a pecuniary damage to support ten thousand small businesses [15]. Nevertheless, that makes only 3% of 16.7 trillion dollars paid to those bank employees.

The Big Three (Standard &Poor's, Moody's Investor Service and Fitch) of rating companies had a criminal conflict of interests for providing the highest ratings in debt liabilities. Practically, that area also was not regulated by state institutions.

However, those companies continue to enjoy the monopoly right to rise and fall down the investment ratings of companies, banks, and states. In particular, for Ukraine and its economic agents it brings about growing prices for international credits. The promised investigations of those companies' actions concerning the highest ratings of the securitized sub-prime mortgages were not made. No one company hold responsibility for the loss of pension savings of millions of Americans, while their monopoly abolishment so far is under discussion.

The project of a new financial order provides for the regulation of that area, but, as it is observed, the projects are not expected to become realities soon.

With respect to improvement of transparency in financial institutions activities and restore people's confidence, there are more questions than answers here. What transparency could be implied when the Senate in the USA can not audit the FRS who had earned enormous funds due to the crisis? Also, it is not simple to implement the declared by G20 leaders measures on restricting of tax benefits, offshore zones, etc.

All those events have already caused significant changes on financial markets. In particular, the World Economic Forum of 2009 made a new rating of cities and countries with the developed financial systems. New York ceased to be a world financial capital, having moved to the third place. The first place takes London , then comes Australia, the fourth and the fifth places belong to Singapore and Hong-Kong, respectively.

In general, the formation of a new order should proceed at the background of the crisis, much more terrible than the economic one. As the academician Serhii Kapytsya justly notes, deep crisis of spiritual assets is implied, that had been created for two millenniums. And that is family disruptions, a great many of illegitimate infants, amoral businesses running without taking into account the perspectives for future on the planet. In this respect, Matt Taibbie, the author of the scandal article about the activity of the USA largest investment bank Goldman Sachs, said: «… in the society which is managed by free markets and free options, the organized greed will always win the non-organized democracy» [16].

In this context, there is much to think over in Ukraine, where political elite is not the authority among nation, and there has not been confidence in business for all years of independence. Absence of reliable political elite does not allow using the findings of national scientists concerning surmounting the global crisis, to take part in the formation of a new financial order, which complicates the economic situation and slows down the recovery of economic growth.

It is impossible to highlight all aspects of this problem within one paper. The situation either complicates, or simplifies, and we will analyze further events within the frames of a real time, pointing out what projects respectively creation of future financial order will be successfully implemented, and what not, and what outcomes for all of us it will be.

Completing this paper, we will cite the Russian trader Oleksandr Boryanskiy, who said: «We are undergoing a historic adventure. The biggest Wall Street stock exchange has not had the financial meltdown of that kind for over sixty years. 2008 year will be a subject for study in the text-books. It is always turbulent and exceptional on the crossings of history. And we find ourselves here. The one, who manages to survive, will be able to enjoy great future. And no more comments here» [17].

We can add to the noted above, that the named area for a long time will be a subject for further scientific researches and will arise great interest among scientists, practical experts and regulators both, in individual countries, and in international scale.

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