

## Mississippi Model Security Council Issue Papers

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### *Global Financial Security*

With the advent of the age of globalization and the growth of integrated international economic institutions, the dangers associated with global financial insecurity are more evident now than at any other point in history. Anxiety associated with this idea is related to what many economic scholars refer to as the “contagion effect”<sup>1</sup>. This concept, originally defined within the context of individual state economies as the possibility of a downturn in one sector of business to consequentially affect the health of other business sectors (just as a diseased person might infect those around them), has now been linked to international business as well as the economic stability of entire states. This implies that a sudden shock to one sector of business in a state could create a ripple effect strong enough to adversely affect not only the financial stability of the state in question, but also economies with which the state has strong connections. The contagion effect has been used by some to explain the current global recession by pointing to the negative externalities associated with financial melt-downs in three centers of international business: Southeast Asia, the United States, and the European Union<sup>1</sup>.

The Asian financial crisis of 1997 was the first in a series of major economic breakdowns that sparked discussion of the possibility of the contagion effect becoming reality. The origin of the problem was the rapid devaluation of the Thai currency<sup>2</sup>. Some theorize the crash in Thailand, and the subsequent financial crises in other Southeast Asian economies (and eventually China) were due, at least in part, to irresponsible capital investment for short-term gain and the convenience of fixed international exchange rates that increased lending between states and magnified the dangers of “foreign exchange risk.” Following the outbreak of the crisis, the International Monetary Fund intervened, beginning a \$40 billion strategy to halt the downward spiral of the most dramatically affected economies. Most countries in the area showed signs of recovery within two years<sup>2</sup>.

The current recession in the United States is presenting itself as the worst post-World War II contraction ever seen. As for the cause, it has been debated and focused on the public monetary policy and also the practices of private financial institutions<sup>3</sup>. It has been claimed by some economists that an extremely indebted US economy is the starting

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1. Forbes, Kristin. "International Financial Contagion." By Stijn Claessens. N.p.: n.p., n.d. N. pag. Web. 18 Oct. 2012. <<http://web.mit.edu/kjforbes/www/Papers/ContagionBook-Overview.pdf>>.

2. "What Caused East Asia's Financial Crisis?" *The Federal Reserve Bank of San Francisco: Economic Research, Educational Resources, Community Development, Consumer and Banking Information*. The Federal Reserve Bank of San Francisco, n.d. Web. 19 Oct. 2012. <<http://www.frbsf.org/econsrch/wklyltr/wklyltr98/e198-24.html>>.

point of the financial crisis. Along with this would be high private debt levels, which would lead to a deeper affecting recession and a slower recovery rate. Starting in early 2009, Real GDP was beginning to fall at a rate that hasn't been observed in over 50 years. The US Domestic demand has been in decline for 5 consecutive quarters and a report in 2009 made the statement that \$14.5 Trillion of global company value had been eliminated since the crisis had started. Income levels have dropped dramatically and millions of people have given up looking for jobs and are taking advantage of the federal disability programs. An increase in the concentration of wealth has been observed within the US. This corresponds with the increasing number of poor sharing from the same widely spread portion of only 9% of the wealth. It is becoming harder for middle and lower class to acquire and keep wealth because of their piece of the national income dropping as well<sup>3</sup>.

The European sovereign debt crisis is an ongoing situation that has left government debt in countries almost impossible to pay back without assistance<sup>4</sup>. The structure to the Eurozone as a monetary union without fiscal union, such as different tax rules, played an important player in the contribution to the crisis and affected the capability of European leaders to respond. Causes for this crisis vary by country. The case for several of these countries was a transfer of private debts associated with properties into sovereign debt. This happened as a result of banking system bailouts. Because European banks hold a large sum of the sovereign debt, a concern regarding a way to fix these systems was simply acting as negative reinforcement. To restore a sense of confidence in Europe, a European Fiscal Compact was implemented which included the commitment of all participating countries to introduce a balanced budget amendment as part of their national law. The European Central Bank has since taken measures in order to maintain the flow of money between European banks by providing weaker banks with loans exceeding 1 Trillion Euros. This crisis has taken its toll on European politics which has led to shifts of power in several countries including Greece, Ireland, Italy, Portugal, Spain, and France<sup>4</sup>.

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3. Marshall, John. "The Financial Crisis in the US: Key Events, Causes and Responses." *Voltaire Net*. House of Commons Library, 22 Apr. 2009. Web. 20 Oct. 2012. <[http://www.voltairenet.org/IMG/pdf/US\\_Financial\\_Crisis.pdf](http://www.voltairenet.org/IMG/pdf/US_Financial_Crisis.pdf)>.

4. Haidar, Jamal Ibrahim, 2012. "[Sovereign Credit Risk in the Eurozone](#)," *World Economics*, *World Economics*, vol. 13(1), pages 123-136, March