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"Globalization and the Crisis"

I describe in this paper two connections between globalization and the crisis, one subsidiary, the other oblique.

The oblique connection is between globalization and the competitive pressure that encouraged excessive risk taking. Financial institutions stretched for risk and gambled for survival as their profit margins were squeezed by growing competition. The intensification of competitive pressure reflected the increasing ability of commercial and investment banks to infringe on one another's turf. It reflected the growing overlap between banks and markets resulting from the dual processes of securitization and disintermediation. But another source of pressure was international competition, as finance was globalized, and in Europe in particular as the single market led to increasing in cross-border competition. It is no coincidence that previously sleepy Landesbanken were so heavily invested in toxic securities. I regard this as an indirect but important consequence of financial globalization.

The subsidiary connection is between global imbalances and the asset bubble. The match that ignited the fire lay elsewhere, in lax regulation and perverse incentives in financial markets. But global imbalances poured fuel on the blames, leading to a once-every-hundred-year firestorm. With significant amounts of foreign capital, official capital in particular, flowing toward the United States, long-term interest rates were lower than otherwise. This, of course, is Mr. Greenspan's own explanation for his now notorious bond market "conundrum." The low level of long-rates encouraged households to assume additional mortgage debt. It encouraged portfolio managers to stretch for yield. It encouraged additional risk taking by fund managers who found it increasingly difficult to meet historical benchmarks.

The “subsidiary” and “oblique” language signals that I see globalization as related but not central to the crisis. Fundamentally I see the crisis as the result of flawed regulation and perverse incentives in financial markets.