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Global Economy 1987-2017 – Unpredictability of Predictability

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ABSTRACT
In this paper critical developments that shaped the global economy from 1987 until 2017 were analyzed. The globalization process was addressed from the perspectives of convergence or divergence paths and outcomes. The lessons learned were presented. The need for historical perspective is emphasized. Instead of "superior or inferior model" qualifications, the plurality of ideas is recognized. The arrogance of perceived, yet fragmented knowledge proved to be devastating in the number of economic episodes.

Key words: *financial crisis, globalization, Washington Consensus, Beijing Consensus, BRICs, CIS*

JEL Classification: G01, N71, O4

INTRODUCTION

The focus of this paper is on a few key developments that shaped the global economy in the 1987-2017 period. The reason for this 30-year timeframe lies in the significance of the journey started with the first profound market crash after the World War II. Several historical "first" has happened from 1987 till today. These developments are presented chronologically.

This paper seeks to answer two research questions. The first research question is: What are the defining events of the world economy from 1987 until 2017? The second research question is: What are the lessons learned? Therefore, the events that defined the last 30 years are critically identified: from stock market crash in 1987, thru the collapse of the Soviet Union and Easter block, creation of euro, rise of Washington Consensus, emergence of Beijing Consensus, via the Great Recession and creation of cryptocurrency (bitcoin). Globalization was viewed from the convergence and divergence perspectives. Analysis of the key economic events leads to few lessons worth a critical and constructive debate.

THE END OF HISTORY OR THE NEW BEGINNING: 1987-1991

The stock market crash known as "Black Monday" happened in October of 1987. It is worth noticing that very few experts predicted it. Fox (2013) pointed out that the term word "bubble" appeared in only 33 articles in the leading *Journal of Finance* (1946-1987). Yet from November 2012 till November 2013 there were 36 articles addressing this topic. The market crash of 1987 emphasized "the unprecedented extent to which financial markets worldwide had become intertwined and technologically interconnected." (Federal Reserve, 2013).The U.S. stock market

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lost 22.6 % in a day, while the market in New Zealand collapsed by 60%. Some of the reasons for a market crash were rise in foreign investment in the USA; trade in "portfolio insurance and involvement in extensive use of options and derivatives. This crises raised serious questions "about both the information content of prices and the stability of the risk measures used in finance" (Fox, 2013) . Federal Reserves reacted immediately by actively stimulating banks to continue lending. The crisis was successfully and swiftly contained. Though, this increased the probability for moral hazard behavior in the future that reoccurred time and again since 1987.

The fall of Berlin wall in 1989 and subsequent reunification of East and West Germany in 1990, historically symbolize the end of one era and the beginning of another. Looking back, two other defining moments for world history were also shaped by Germany, the end of World War I and II. The Treaty of Versailles (1919) defined the borders for a number of countries. This had implicitly influenced their destinies in years to come. In 1945, the Yalta Conference marked the new borders and spheres of influences for the USA, UK and France at the one side, and the Soviet Union on the other side. All three historical turning points called for new quest for identity for the major players as well as for other countries in the world. Therefore, the last decade of the 20th century and the first decade of the 21st century were characterized by the new quests for identity: from united Germany, to new Russia, from the single superpower, USA, to the emerging superpower China, from the Nelson Mandela's South Africa to nuclear North Korea.

The disintegration of Soviet Union and demise of its economic, military and ideological structure (CMEA and Warsaw Pact) triggered the conviction of "the end of history". The last decade of the 20th century became a testament of the market power, benefits of integration processes and globalization. However, the serious challenges were present as well.

The Washington Consensus became the economic and political symbol of this new area. Formulated by John Williamson in 1989 (focused on economic development in Latin America) and was later expended by International Financial Institutions and the US Treasury. Moises Naim (2000) describes it as "an ideology for a world that was pinning for something to replace the god of socialism that had just failed" (in Williamson 2004, p. 16). The initial "Ten Commandments" comprised of: fiscal discipline; reorientation of public expenditures; tax reforms; financial liberalization; unified and competitive exchange rates; trade liberalization; openness to FDI; privatization, deregulation and secure property rights. The expended Washington Consensus version in addition to the later included: legal and political reform, regulatory institutions, anti-corruption, labor market flexibility,; WTO agreements, financial codes and standards, "prudent" capital account opening, non-intermediate exchange rate regimes, social safety nets and poverty reduction (Rodrik 2002).

CONVERGING OR DIVERGING WORLD: 1992-2004

Bonciu (2017) debates if the countries were converging, diverging or staying apart during the period since the collapsed of the Soviet Union. Convergence evolves at three levels: "a. developing countries will convergence with the developed ones; b. Central and East European countries will convergence with West Europe: c. different social, cultural and political systems will converge with the western style democracy and liberal market economy" (p. 52) .

The following developments in the last decade of the 20th century, partially support convergence trends, while unveiling benefits and challenges of the new era.

The first, creation of one of the largest economic integration block in the world, NAFTA, was based on the premise of free trade benefits that will "lift all boats up". It was expected that elimination of trade barrier brings improvement in living standards and protection of intellectual property rights, will benefit all participants. Still, the 1992 Presidential candidate, Ross Perot warned on the "giant sucking sound" that will eliminate manufacturing jobs in the USA. A premise that has regained supporters particularly since the Great Recession.

The second event happened in 1996 when South Korea, the first country that made impossible possible, making the grand leap forward from developing to developed economy, became a member of OECD. This has been later identified as one of the possible contributors to the country's financial collapse in 1997. South Korea's membership to the exclusive club of the most developed countries enabled significant foreign investment into the country which facilitated economic development, while making country more receptive to the global financial market's swings. Unfortunately, the financial crisis in Thailand (that followed development prescription by Washington consensus), triggered the global investors 'concerns that all countries in the region were prone to the same destiny. Thus the capital inflow, not only to Thailand but to other countries in the region as well, including South Korea, started to dry out and the reverse process, capital outflow followed (Balino & Ubide, 1999). The South East Asian crisis created deep mistrust in International Monetary Fund and Washington Consensus doctrine.

The third episode, the collapse of Long Term Capital Management (LTCM) in 1998, almost, brought global financial system to the brink of abyss. This crisis unveiled all the challenges of the unregulated hedge funds market alongside with moral hazard behavior and the notion of "too big to fail". Edwards (1999) provides detailed analysis of the hedging markets as well as the reasons and consequences of the collapse of the LTCM Unfortunately, lessons learned from this story were short lived, as the developments in the next century will demonstrate.

The fourth development, the launching of the single currency, euro in 1999 symbolized the ultimate triumph of the European integration. The Convergence criteria was developed by the Maastricht Treaty in 1991 and was influenced by German hard monetary and fiscal policy. The criteria were based on: price stability, sound and sustainable public finances, exchange rate stability and long-term interest rates limits (http://www.consilium.europa.eu/en/policies/joining-euro-area/convergence-criteria/). The road toward single currency was long and painful. However, most countries switched to euro without fulfilling the convergence criteria. Ozturk & Sozdemin (2015) suggested that Greece should have been left out the single currency system. Instead it was accepted in 2001. The subsequent financial crisis in the country, which seriously challenged the European Monetary Union could have possibly been avoided.

Almost simultaneously with the disintegration of the Soviet Union, the fifth development, creation of the Commonwealth of Independent States – CIS (1991), and the subsequent multilateral economic agreements (Economic Union 1993, Eurasian Economic Community 2000, Common Economic Space 2003) happened. All previous states of the Soviet Union with exception of Baltic states who joined the European Union, became members of the CIS and some of the above economic integration groupings. The significance of the mutual trade flows between the member states of CIS was limited (2000-2016, CIS export was between 16-19% of the total export of member states, while import at the same time, was between 46% in 2000 and dropped to 22% in 2016 (http://www.cisstat.com/eng/cis.htm). However, a number of CIS member countries depend on the remittances from migrant workers working in Russia (Table 1). In the case of Tajikistan 51% of GDP, and in the case of Kyrgyzstan, 31% of GDP comes from remittances from Russia (Ryazantsev, 2016). The Russian political and military influence was and is likewise noticeable.

Table 1. Personal Remittances (2013) from Russia to CIS Countries in millions of US $

Uzbekistan	6.689
Tajikistan	4.173
Ukraine	3.424
Kyrgyzstan	2.106
Armenia	1.715
Azerbaijan	1.340
Moldova	1.279
Kazakhstan	561
Belarus	399
Turkmenistan	40
CIS COUNTRIES Total :	21.726

Source: Central Bank of Russia
http://www.cbr.ru/eng/statistics/?Prtid=svs&ch=TGO_fiz_post#CheckedItem

The fall of Twin Towers in New York on September 11, 2001 was another defining event of the 21st century. It was on this date that the new grouping, for the purpose of creating a new investment fund, was created by Goldman Sachs' chief economist. O'Neill explained, "What 9/11 told me was that there was no way that globalization was going to be Americanization in the future – nor should it be. In order for globalization to advance, it had to be accepted by more people … but not by imposing the dominant American social and philosophical beliefs and structures." (Tett, 2010) BRIC countries (Brazil, Russia, India and China) officially met for the first time in 2008. Although BRICS countries' (South Africa joined in 2010) collaboration is not significant for the time being, the creation of the New Development Bank (2014) indicates a deeper commitment. The power that 42% of global population and 30% of global output combined with the growing middle class (that can surpass the G7 by 2020) should not be underestimated.

THEORETICAL VIEWS

The optimistic view of globalization emphasizing benefits of the pluralistic culture has faded since 2001. "The generalized trust" started to crumble (Chan 2007). Chan use "generalized trust" as the measure for the total effect of globalization on national values. He suggests positive impact on generalized trust, however, if globalization generates economic inequalities, its impact on national values is negative. Although the global GDP was mostly moving upward, the closer analysis by countries and inside countries, gave a mixed picture. The gap between rich and poor was widening. This trend has been deepening over time without serious consideration inside and between countries. Bonciu (2017) referencing findings of Oxfarm International report for 2017, states "that number of people that own wealth equal to 50% of the world population" declined from 388 people in 2010 to only eight people in 2016!

When a robust analysis that focused on the economic, demographic, knowledge, financial and political dimensions and global convergence from 1960-2009 was conducted it revealed illuminating results. Instead of convergence, anticipated to occur with globalization, the divergent forces were more powerful (Berry et allies 2013). Although the literature suggests convergence among countries (Dobbin et allies, 2007; Polillo & Guillen, 2005; Fourcade-Gourinchas & Babb 2002) thru: competition, coercion, emulation, mimicry and normative pressures the opposite has been recorded. Berry et allies (2013) tested convergence and divergence forces in the global system and within global subcomponents. Their results indicated that "since the mid-20th century, globalizing forces have encourage divergence across countries due to diversification, differentiation and specialization dynamics", since all five test components (economic, demographic, knowledge, financial and political) are positive and statistically significant. When testing development within each sub-component of the global system (core, semi-peripheral and peripheral countries; trade blocks and its member states and among different trade blocks), similar results occurred. The convergence was recorded only in: 1. Demographic component in the core countries, 2. Economic volumes for the original 11 member countries of the Eurozone and 3. Financial components in NAFTA. The overall finings of this study were that "divergence in the world as a whole is driven by divergence between clusters, with little convergence within clusters" (p. 401).

NEW CONSENSUS AND THE GREAT RECESSION – 2004-2017

While the pillars of the Washington Consensus were being tested and challenged globally, the new Consensus was emerging: The Beijing Consensus. Since economic reforms introduced by Deng Xiaoping, China achieved (1978-2012) an impressive real GDP average growth rate of 9.4%. The Chinese economic development path and its rising role in the global economy became noticeable. Ramo (2004) suggested that the Beijing Consensus emerged as an alternative global development model. It included components like, quality of life, politics and global balance of main pillars are: institutional innovation; equitable and sustainable development and self-determination. Although focused on Chinese development, many developing countries viewed it as an alternative to the Washington approach. Chinese position as a new emerging super power became evident in 2010, when China took over Japan as the second largest economy in the world. The departure from the previous Deng Xiaong Ping's maxim "hide our capabilities and bide our time; never try to take the lead", became evident with the creation of "One Belt, One Road" (2013) and Asian Infrastructure Investment Bank (2016). Chinese economic, ideological and military influence and control are noticeable and significant. The President of China, Xi Jinping emphasized this in his address at the 19th Communist Party's Congress (2017) "It is time for us to take the central stage in the world."

THE GREAT RECESSION

As Beijing Consensus was evolving, the new global storm was set in motion. This one brought the global economy to the deepest downfall since the Great Depression. Only a few years prior (2003) to the Great Recession, a Nobel Prize laureate for economics, Lucas, suggested that the "problem of depression-prevention had been solved." Fox (2013) summed up this new approach: "a combination of steady, rule-based monetary policy and a few automatic fiscal stabilizers—such as increased unemployment insurance payments as people lose their jobs and lower tax receipts as incomes fall—were all it took to tame the business cycle." Instead, like the previous financial crises demonstrated, *unpredictability of the predictability* outlined the nature of financial markets the best. The previous experiences suggested the need for the swift and significant intervention by central banks. The bailout that followed was generous. The USA alone committed initially thru TARP $ 700 billion, the amount was later reduced to $475 billion. (U.S. Department of the Treasury, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx).

This time, the system survived almost unchanged. Though, one can look at this as mixed blessing, since a need for reforms has been postponed or eliminated. The Great Recession exposed the limitations of the market economy while at the same time demonstrated a power of government intervention.

CREATION OF CRYPTOCURRENCY

One can argue that the Great Recession made possible an unprecedented birth (2009) of the cryptocurrency, bitcoin. The creation of the new currency by an unknown founder at an unknown location made everyone wondered. Henry Kissinger once expressed his doubts in euro, indicating the fragility of the currency lacking an army to defend it! This time, the new currency, bitcoin entered the global stage without a central bank nor military backing! Is this the ultimate end of the nation state, central banks and need for national defense or the ultimate testament of the power of globalization? The unprecedented value rise of this currency is recorded in Figure 1 Its performance is suggesting next potential bubble to burst.

Figure 1. Bitcoin Value in US Dollars (2013-2017)

Source:https://encrypted.google.com/finance/chart?rlz=1C1GGRV_enUS751US751&q=CURRENCY:BTCUSD&tkr=1&p=5Y&chst=vkc&chs=268x94&chsc=1.875&ei=ZtLbWcH1OouVmQH4qYWgBw

BREXIT AND US ELECTIONS

In 2016, the EU exit vote in the UK, and the election of the Republican presidential candidate in the USA, have common denominator: call for regaining national sovereignty after the deepest and longest economic downfall since the Great Depression. Gross (2017) identified four reasons of UK discontent that solidified the no EU vote: “a divergence between the United Kingdom and the continent about the meaning of the European project and the nature of sovereignty; a gradual estrangement of British political parties from the public; the aftermath of the 2008 financial crisis; and Brussels’ lackluster management of the EU’s problems.” In the case of presidential victory of Donald Trump, the comprehensive analysis is yet to be presented. Some of the reasons for his victory are linked to the economic and political divide between haves and have nots and negative outcomes of globalization, which significantly worsen since the Great Recession. The severity of these sentiments was either ignored or not adequately acknowledged by other candidates. The slogan “Make America Great Again”, echoes the slogans from BREXIT campaign: “Let’s Take Back Control”. President’s Trump inaugural address emphasized these sentiments: “Washington flourished – but the people did not share in its wealth. Politicians prospered – but the jobs left, and the factories closed. The establishment protected itself, but not the citizens of our country” (https://www.whitehouse.gov/inaugural-address).

THE LESSONS LEARNED

Thirty years is a long period of time that allows for a process to be initiated and results to be harvested. In this paper critical defining episodes were addressed. There are few lessons that are derived from the 1987-2017 period.

The first one can be expressed as unpredictability of the predictability. There were limited studies predicting the collapse of the Soviet Union and the big crash of 1987. Both had happened. There was an idealistic prediction about “the end of history”. It did not happen. The market doctrine, expressed in Washington Consensus, was challenged by the holistic approach of Beijing

Consensus. The notion that the currency needs to have an army to defend it has been challenged. The economic convergence, expected to happen with globalization, was modest and present only in a few cases.

The second finding of this analysis is a need for the historical perspective. In a number of situations (e.g. financial crisis presented in this paper and others not covered here) the lessons from the past were almost completely ignored. Although all economic crisis have some unique features, in general, "*plus ça change, plus c'est la même chose,*" the same factors - overheated economy (where all, or few factors occur: high inflation, high levels of credit, a low savings rate, low interest rates, an appreciating currency), and some form of economic bubble, were universally present.

The third takeaway is recognition of the plurality of ideas, expressed with the "one size does not fit all" approach. Therefore the qualification like "superior or inferior model" is misleading and should be avoided, particularly in the academic discourse. The evolution of economic theories, developed and suitable for different circumstances speaks in favor of this view. The Washington Consensus and the Beijing Consensus both have place in the economic development literature and applications in different countries at different times.

The final lesson that this paper conveys is the need for revisiting Socrates saying, "I know that I know nothing". Proclamations of "the end of history" or "problem of depression-prevention has been solved" are good illustrations of this. The arrogance of perceived, yet fragmented knowledge, proved to be devastating in a number of global crisis, and not only economic ones.

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