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Economic Crisis and Backflow of International Capital movements

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This paper focuses on the backflow of international capital movement in world economic crisis. We have seen that event in today's crisis as well as the World Great Depression of the 1930s. Then we examine both backflow on the U. S. balance of payments at some length.

Keywords: world economic crisis, backflow of international capital movement, U.S. balance of payments, U.S. international investment position, financial derivatives, W. A. Lewis, Junnosuke Inoue

Introduction

The global economic crisis after the "Lehman Shock" on September 15, 2008 marked the first economic calamity of this century, as evident in phrases such as "since the Great Depression" or "once in 100 years." Many studies analyzing the causes, development, and future implications of this problem have been published and the market for publications on this topic is saturated. Although some consider that the economic crisis has "finally turned the corner",[1] the reality suggests that uncertainty persists over whether the economy's unilinear recovery process will continue.

As described above, while the events since the global economic crisis began are apparent and some conclusions may be drawn based on the analyses and overall findings, these conclusions should be considered as tentative for the time being. Such a caveat is in order, since revisions may be required in light of future developments. Moreover, since this crisis is still an ongoing event, it may not be

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1) Yumoto [2010], p. v.

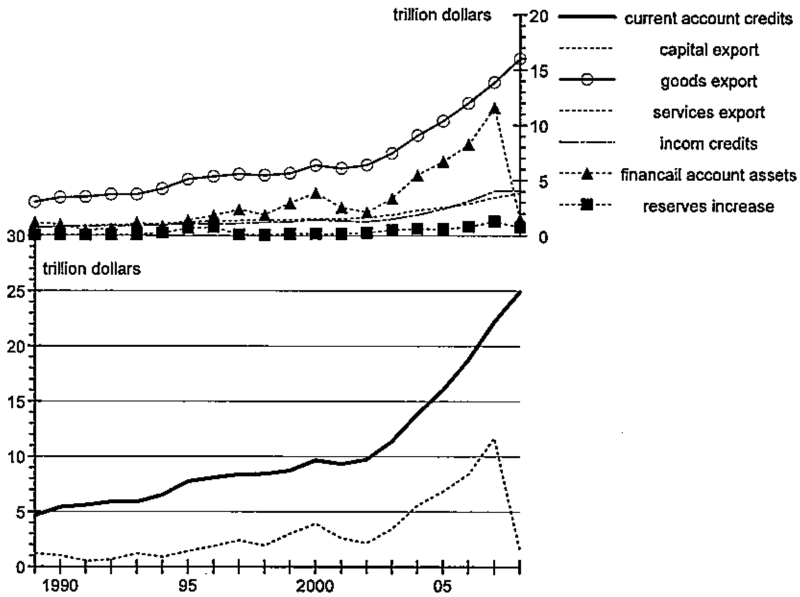

Figure 1. Recent Global International Economic Transactions.
Capital export consists of the financial account and capital account assets.
Source; IMF [2009a] Part 2, pp. 13, 86, 95, 104, 119.

possible to obtain adequate data. In other words, an analysis of the current conditions unavoidably meets with some difficulties, owing to the lack of data available.

As widely acknowledged, this economic crisis began with the subprime problem that represented only a part of the U.S. housing market. It then rapidly developed into a global crisis brought on by the Lehman Shock. Although the issue manifested as early as 2007 in the U.S., it eventually engulfed the global economy in the fall of 2008. The impact of this event on global economic activity thus intensified as the seriousness and scale of this economic crisis increased.

With this in mind, Figure 1 shows the recent shifts in global economic transactions using IMF data (2009a). The table does not provide a precise picture, because it scatters the values of current transactions for credits (positive) and the values of capital transactions for assets (negative). However, it still adequately confirms the overall trend.

As shown in the bottom section, while the growth trends of current account credits remain unchanged from 2007 to 2008(The table omits the data on current transfer credits that are part of the current account because of their small scale.). The table suggests a strong declining trend marked particularly by a significant decrease in capital exports from 2007 to 2008. Although a similar phenomenon was observed during 2000-2002 when the U.S. dot-com bubble burst, the magnitude of the above decline can be described as an incomparable event. This capital export decline was also caused by a decrease in the assets of financial account(i.e. capital export according to the traditional terminology).[2]

The abnormally rapid contraction in capital movements can easily be attributed, to some extent, to the backflow of capital movements caused by a recovery from capital exports or a withdrawal from capital imports. Considering that such a rapid, large-scale backflow phenomenon may have occurred during this economic crisis, and has significantly influenced the calamity's development, a recollection of similar circumstances during the Great Depression era after 1929 would be justified. The analysis of this ongoing crisis with no foreseeable conclusion undeniably involves analyzing the fundamental problems discussed previously. Hence, the importance of learning from history should be emphasized.

Therefore, this paper first provides a general overview on the backflow of capital movements that originated in the U.S. in the 1930s and establishes its historical significance. It then aims to examine the implications of similar incidents during this economic crisis.

1. Backflow of Capital movements during the Great Depression

(1) Junnosuke Inoue and W. A. Lewis

There exist many domestic and international studies on the onset of the Great Depression in 1929 that lead to a worldwide economic depression.[3] Although this section does not summarize or review these studies, a brief, retrospective examination of the views held by two experts who lived in that era would be beneficial.

Junnosuke Inoue (1869-1932), Japan's finance minister during the Great Depression, lifted the gold embargo and eventually suffered a tragic death. Whereas the gold embargo was lifted in January 1930, the Great Depression had commenced from the previous October in the U.S. On June 16, 1930, Inoue gave a lecture titled, "The Status of Business Communities in Japan and the Japanese Resolutions" at the Japan Trade Association's regular meeting.

2) Balance of payments statistics for the current IMF members are based on IMF [1993]. The IMF newly published a *Balance of Payments and International Investment Position Manual*, 6th Edition IMF [2009b], in 2009. Therefore, statistical data are expected to be published using this manual in the near future.

3) This paper cites only Yoshitomi [1965] and Takumi [1994] as Japanese references and Friedman and Schwartz [1963] and [1965] as English references.

"Therefore, the fact that money came back to the U.S. from overseas rather than lending indicates that U.S. and European finances are having significant impact on the economy. Stock prices gradually started to go up in the U.S. last November and the Federal Reserve System increased interest rates to try to halt this phenomenon. This caused the crash which led to the Great Depression." "On the one hand, the conspicuous fact is that an excessive availability of agricultural products instigated the decline in the price of those items." "The price of agricultural products has been significantly reduced due to the two interwoven factors which include an excessive availability of agricultural products and decreased consumption around the world." (Inoue [1930a], pp. 394-395)

Especially noteworthy is that the lecture mentioned the backflow of capital movements to the U.S. and the worldwide agricultural depression. Subsequently, Inoue made the following statement in a pamphlet, "Global Economic Recession and the Japanese Resolutions," published in August 1930.

"A significant cause which accelerated the general tendency of price declines can be identified. It is the decline in overseas investments made by the U.S. and U.K." "The U.S. continued to enjoy tremendous prosperity by lending money. This increases its money supply and exports. The U.S. prosperity led to a significant rise in the U.S. stock prices, which started in mid-1928. The country witnessed extreme price increases last year." "The rise in overall interest rates, call loan rates, and stock prices made it impossible to make an investment overseas." "The U.K. is also facing almost identical conditions. Along with the phenomenon in which overseas investment is not possible due to rising interest rates, a large amount of capital returned to the U.S. from Europe instead. The decline in the overseas investments made by the U.S. and U.K. and an inflow of European and Asian capital to the U.S. clearly led to the loss of stability in financial markets around the world, which subsequently weakened purchasing power of each country. Coupled with the general trend in price declines and overproduction of foodstuffs and raw materials around the world, the decline in the purchasing power is further lowering the prices" (Inoue [1930b], pp. 583-585, also refer to p. 589).

This suggests that the Japanese finance minister at that time was strongly interested in the backflow of capital movements to the U.S. along with the "overproduction of foodstuffs and raw materials."[4]

4) The original text of "Global Economic Recession and the Japanese Resolutions" is a small booklet consisting of 62 pages. However, it also contains a 90-page supplemental volume called "Fundamental Analysis of Global Recession," which was not included in *Junnosuke Inoue Ronso*. The volume discusses the following

In a compilation of his lectures from 1944 to 1947 at the London School of Economics (W. A. Lewis [1949]), W.A. Lewis (1915-1995), winner of the 1979 Nobel Prize in Economics, traced the capital movements during the interwar period.

"The fact that New York had not adequate machinery for foreign lending was unfortunate. There were no specialized houses with long tradition; the cost of issues was very high; and the investing public fickle, shifting its interest too easy between foreign and domestic capital issues. This added to instability; the suddenness with which the flow of foreign loans contracted did much eventually to increase the difficulties of overseas countries." "Problems left by the war remained unsolved, especially the creation of a stable international currency system, the adjustment of the size of the agricultural economy, and the reorientation of Britain, of Germany and of France in the post-war world. So soon as America ceased to expand and to lend, then underlying maladjustments were to come out and to take charge." (W. A. Lewis [1949], p. 50)

He also placed emphasis on a problem of primary products including agricultural products as follows.

"Its misfortunes were due principally to the fact that production of primary commodities after the war was somewhat in excess of demand." "the significant point remains that if primary commodity markets had not been so insecure the crisis of 1929 would not have become a great depression." (W.A. Lewis [1949], p. 196) 5)

While the former became a politician after serving as the Governor of the Bank of Japan, the latter was an up-and-coming researcher. Despite their different backgrounds and analyses, the fact that both of them focused on the same condition, in principle, deserves special attention. The main instability factors affecting

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five points as "characteristics of global economic recession" and "most notable phenomena."

1. "Global overproduction of major foodstuffs and raw materials is the number one cause of price declines."
2. "Feverish speculation on stocks in the United States during the last two to three years has concentrated global funds in the country." "It has reduced investments to foreign nations." "It has also weakened industries in foreign nations, dragged down the price of products in these industries, and diminished the purchasing power. These factors are major causes of global trading slumps."
3. "The recent exacerbated recession around the world is due to the United States having fallen into severe recession since the stock market crashed last fall, which reduced its purchasing power."
4. A decline in the silver market price "significantly reduced the purchasing power of countries which adopt the silver standard."
5. "Countries that increased the level of protective tariffs continued to emerge, exacerbating foreign trade slumps globally." Inoue [1930c], pp. 2-3.

5) Refer to Watanabe [1975] for the global agricultural recession during the interwar period. The experience gained from the recession has historical significance, since it led to the formulation of academic theories in development economics after World War II, which argue for the industrialization of developing countries.

the global economy during the interwar period can comprehensively be summarized by including the issues of the German reparation and the western European allies' war debts to the United States in the aftermath of World War I.[6]

As described above, the experts who actually experienced the global depression viewed the sudden backflow of capital movements as a factor meriting attention. With this in mind, the analysis in the next section will focus on the balance of payments as they relate to the U.S., which was the major capital exporter at that time.

(2) The Great Depression of 1929 and the Backflow of Capital Movements Relating to the U.S.

In the 1920s, the major capital exporters were the U.S., U.K., and France. While France was inclined to short-term capital exports, Britain was hampered by an unstable structure of so-called "short-term borrowing and long-term lending" backed by French capital. Under these circumstances, the U.S. became the only stable, long-term capital exporter.

However, the U.S. balance of payments showed a significant current account surpluses owing to a large trade balance. Moreover, the invisible balance was almost in equilibrium. In the nineteenth century, Britain was widely understood to be supplying capital to the world based on the current account surpluses created by surpluses in the invisible trade that exceeded a large trade deficits. This indicates that the country was recovering overseas investments, including investment income, despite the deficit in the trade balance, while sustaining the net exports of capital supported by the current account surplus. On the other hand, the U.S. balance of payments in the 1920s was not built on adequately secured investment recovery channels. Consequently, international debts tended to accumulate because of the balance of payments situation of the world's largest, stable capital exporting nation. Moreover, debt repayment systems were not established effectively.

The global agricultural recession further curtailed the debt repayment abilities of developing nations. While the "reparations and war debts issues" seemed to be handled effectively to some extent after the Dawes Plan concluded in 1924, such an environment was feasible only with the continuation of American capital exports to Germany, and German's debt obligations to the U.S. continued to accu-

6) Refer to Kato [1975] for information on German reparations and the Allied war debts issues. Additionally, three observations written by Inoue in 1925 [1925a], [1925b], and [1925c] can help in understanding the issues.

mulate.

American capital exports prevented the aforementioned factors from adversely affecting the global economy in the 1920s. In other words, the global economic balance would have collapsed if American capital exports had ceased or the direction of capital movements had been reversed. This scenario was triggered by the Great Depression in 1929.

In light of the foregoing, this section will now examine the trend in major items in the U.S. balance of payments from the 1920s to 1930s. Figure 2 shows that the current account balance surpluses continued to move parallel to the trade balance surpluses during the 1920s. The current account surpluses almost disappeared in the 1930s, as the capital balance deficits declined. Notable changes are observed after 1934. In addition to the current account balance going into deficit, albeit temporarily, the capital balance surplus of the U.S. emerged in a pattern similar to the balance of payments pattern of capital importing countries. Moreover, the balance in gold movement showed significant deficits, indicating a massive inflow of gold into the U.S.

Figure 2 also depicts the invisible trade in the 1920s as mostly balanced. This means that surpluses in the trade balance played a major role in the current

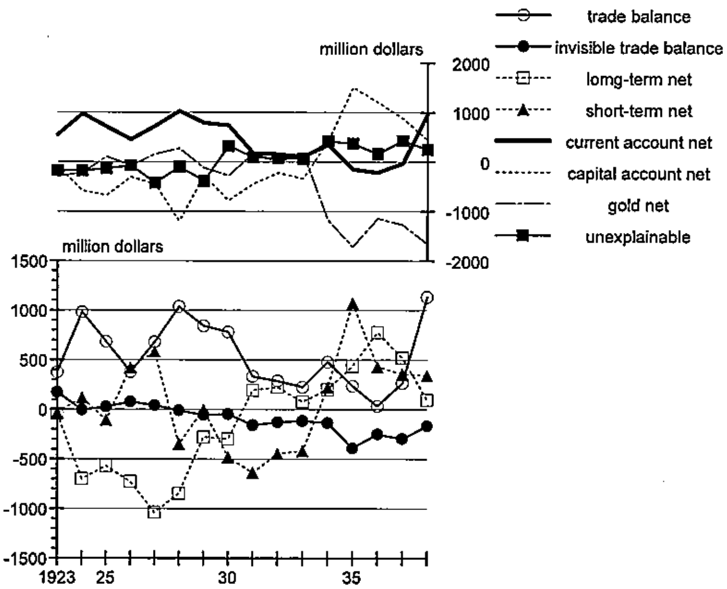

Figure 2. The U.S. Balance of Payments (1923-38)
Source; Larry and Associate [1943] Appendixes Table 1.

account surpluses during this period. Starting in the 1930s, trade surpluses declined (although a surplus increased significantly in 1938) and the invisible went into deficit. These two factors explain the reason for the decline in the surpluses and the emergence of deficits in the current account. The deficits in the long-term capital account balance, which continued in the 1920s, turned into surpluses after 1931. A significant level of surpluses can be observed from 1935 to 1937. Analysis of the short-term capital account balance depicts a lack of consistent patterns in the 1920s. However, the short-term account balance showed a deficit at the beginning of the 1930s, followed by significant surpluses after 1934. In other words, the short-term capital initially experienced excess outflows after the occurrence of the Great Depression and then shifted to excess inflows. An analysis of the balances provides compelling evidence that a clear backflow in the direction of capital movements involving the U.S. cannot be confirmed until the mid-1930s.

These figures are, however, based only on the analysis of the balances and detailed examinations are required. Table 1 shows the U.S. balance of payments, which focuses on the capital account before and after the Great Depression. The average balance of capital account from 1926 to 1929 showed deficits, whereas there was surpluses in the current account. As shown in Figure 2, this current account surplus is based on the trade balance surplus. The average balance of the

Table 1. The U.S. Balance of Payments (1930s, million dollars)

	1926-29 average	30	31	32	33	34	35	36	37	38
current account net	747	735	175	159	108	341	–156	–218	–31	967
credits	6,769	5,553	3,655	2,481	2,377	2,907	3,184	3,436	4,489	4,234
debits	6,022	4,818	3,480	2,322	2,269	2,566	3,340	3,654	4,520	3,267
capital account	–559	–777	–443	–221	–342	422	1,508	1,208	877	441
assets	–1,143	–555	756	478	–13	281	540	232	321	67
liabilities	584	–222	–1,199	–699	–289	111	968	976	556	374
long-term capital	–722	–298	194	225	77	200	436	777	521	97
assets	–939	–364	128	251	–48	185	116	177	276	40
liabilities	217	66	66	–26	165	–15	320	600	245	57
short-term capital	163	–479	–637	–446	–419	222	1,072	431	356	344
assets	–204	–191	628	227	35	96	424	55	45	27
liabilities	367	–288	–1,265	–673	–454	126	648	376	311	317
unexplainable	–247	320	92	73	61	415	368	157	425	249
gold net	59	–278	176	–11	173	–1,178	–1,720	–1,147	–1,271	–1,657

Source; same as Figure 2.

long-term capital account during this period shows deficits that were almost equivalent to the surpluses in the current account balance. While the short-term capital account balance indicates some surpluses, these can be considered to be mostly balanced by the comparable size of the deficits in the "Unexplainable Items."

In the early 1930s, both credits and debits in the current account balance continued to decline until 1933. It is worth noting that the credits declined almost to one-third of the average value from 1926 to 1929, since this reflects significant reductions in the price and volume of international goods, services, and income movements. Additionally, surpluses in the overall current account balance dropped drastically and turned into deficits from 1935 to 1937. This undermined the economic foundation of the U.S., the world's largest capital exporter.

The analysis of the capital account balance illustrates that the level of deficits in the balance (with a large deficit in 1930) diminished, but after 1934, it started to show surpluses, confirming the fact that the country had become a capital importer. The surpluses in the three years from 1935 to 1938, in particular, are conspicuous (a similar trend can be observed in the "Unexplainable Items," which showed no deficits during this period).

However, dividing the balance into assets (U.S. capital) and liabilities (foreign capital) reveals a slightly different picture. Despite a significant deficit recorded in 1930, the assets continued to enjoy a surplus every year from 1931 except for a marginal deficit in 1933. In other words, overseas transactions of American capital after 1931 were based on the recovery activity. On the other hand, the liabilities showed a deficit from 1930 to 1933 but returned to a surplus in 1934, and there was approximately one billion dollars surplus in both 1935 and 1936. This suggests the withdrawal of foreign capital up until 1933 and the resuming of an inflow in 1934.

The above analysis reveals that the U.S. deficits in the capital account balance (net capital export) in the early 1930s were owing to foreign capital recovery exceeding American capital recovery from overseas. It also shows that continuous withdrawal of U.S. capital along with the inflow of foreign capital "turned the country into a net capital importer."

The long-term capital account balance indicated surpluses starting in 1931, and a continuing excess of imports. Dividing the balance into assets and liabilities reveals that assets were surplus every year except for the period between 1931 and 1933, indicating an excess of capital recovery. In principle, liabilities experienced an excess of capital inflow, except in 1932 and 1934. Yet, the amounts from

1935-37 deserve special attention. Next, the short-term capital account balance revealed mostly the same trend as that for the overall capital account balance. This indicates that the country's tendency of capital movements were established by this item. The assets, which show surpluses after 1931, were continuously recovered, particularly in 1931 and 1935. The trend in the short-term capital liabilities demonstrates a typical overall flow of foreign capital, including large volumes of capital recovery until 1933 and the recurring inflow in subsequent years.

Then, let us discusses gold movement. When a decrease in the current account balance surplus turns into a balance deficit, it generally indicates a decline in the capital exporting power. More importantly, it means that the American capital recovery from overseas and the inflow of foreign capital to the U.S. increased. Consequently, more than one billion dollars' worth of gold flowed into the U.S. every year, starting in 1934. The implementation of a gold sterilization policy by the U.S. financial authorities to counter this trend is a widely acknowledged fact.[7)]

An examination of the balance of payments shows that the U.S. remained a net capital exporter after the Great Depression until 1933. This phenomenon was determined by the net result of the direction change in two opposite capital movements, that is between the backflow from an outflow of American capital to capital recovery and the backflow from an inflow of foreign capital to capital recovery. Shifts toward the backflow of capital movements involving the U.S. became apparent in 1931. Previously, the U.S. had played the role of a capital exporter; in the 1920s, it was the main pillar of the global economy, which was undergoing various problems. The country now turned into a capital importer.

The findings on the capital movements mentioned above will now be reviewed, using the U.S. international investment position as source data. Table 2 shows that private assets at the end of 1929 were 2.45 times more than those at the end of 1919, showing significant increases in the short-term assets (3.23 times more) and securities (3.04 times more), in particular. However, total assets declined by approximately 3.3 billion dollars by the end of 1935. While securities and short-

7) Capital movements and gold movement involving the United States are significantly affected by political and economic situations at a given time. Examples of such cases in the 1930s include the European financial crisis of 1931, the end of the gold standard in Britain in 1931, the establishment of Nazi Germany, the World Economic Conference held in London and its failure (1933), the approval of the Gold Reserve Act of 1934 (devaluation of the dollar by revaluating the gold price), the German re-armament in 1935, the Italo-Abyssinian War, the Spanish Civil War that started in 1936, the collapse of the gold bloc and the tripartite financial agreement, the outbreak of the Second Sino-Japanese War in 1937, and the annexation of Austria by Germany in 1938 (the *Anschluss*). However, this paper does not analyze the impact of these events.

Table 2. The U.S. International Investment Position (year end, million dollars)

	1919	29	35
private assets	6,956 (100)	17,009 (245)	13,694 (197)
portfolio	2,576 (100)	7,839 (304)	5,622 (218)
direct investment	3,880 (100)	7,553 (195)	7,219 (186)
short-term	500 (100)	1,617 (323)	853 (171)
private liabilities	3,985 (100)	8,931 (224)	6,329 (159)
portfolio	1,623 (100)	4,304 (265)	3,529 (217)
direct investment	900 (100)	1,400 (156)	1,580 (176)
sequeatrated properties	662 (100)	150 (29)	0 (0)
short-term	800 (100)	3,077 (385)	1,220 (153)
private sector net	2,971 (100)	8,078 (272)	7,365 (248)
government sector net	9,591 (100)	11,685 (122)	11,434 (119)
net international investment position	12,562 (100)	19,763 (157)	18,799 (150)

Source; C. Lewis [1938] pp. 450, 454.

term assets decreased by 2.2 billion dollars and 700 million dollars, respectively, direct investment went down by only about 300 million dollars. A similar trend can be confirmed for the liability side. Large increases in the 1920s can be found in the short-term liabilities (3.85 times more) and securities (2.65 times more) as well. While the short-term liabilities (1.8 billion dollars) and securities (800 million dollars) declined more at the end of 1935 than at the end of 1929, direct investment increased (by close to 200 million dollars). These findings appear to suggest that securities investment and the short-term capital played a major role in the backflow of capital movements in the 1930s involving the United States. The short-term capital movements attracted attention at that time owing to its unpredictable behavior as "hot money." Moreover, international defaults on debentures, then a popular type of securities investment, occurred frequently.[8]

As already widely acknowledged, the Great Depression that started in the U.S. developed into a worldwide economic depression and created a crisis chain reaction including significant declines in gross product and increases in unemployment around the world, frequent financial crises, reductions in global trade, destruction of international debt and credit relations, and collapse of the international gold standard. The United States also changed from being the world's largest capital exporter to being a capital importer. This backflow of capital move-

8) Refer to Hatori [1987] to understand international defaults during this period.

ments can be assumed to be an exacerbating factor in the economic depression.

The outcome of the crisis is also well known. The global economy was dissolved and the economic bloc systems centered on each great power were created. The conflict between the major blocs eventually led to the second world war in human history, which was unprecedented in scale.[9] However, it is essential to note that some of the principles on which the international economic order created by the West after World War II were founded were in response to some of the bitter lessons learned from the war. Several new important elements were eventually incorporated to re-establish the international economic system, since its collapse because of the global depression was so catastrophic. Subsequent severe worldwide economic crises were thus averted.[10] However, the backflow phenomenon of international capital movements observed in the 1930s seems to have recurred, along with the recent global economic crises.

2. Current Global Economy and Capital Movements

The global economy is an aggregation of the entire world's economic activity. To determine the international economic activity apart from each country's domestic economy, the IMF calculates balance of payments by dividing such activity into current transactions and capital transactions. The former is further categorized into goods trade, service trade, income, and current transfers, while the latter is classified into financial transactions (and this category is further divided into direct investment, portfolio investment, financial derivatives, and other investment) and (other) capital transactions. With this in mind, what is the recent trend in international economic transactions? As described previously, the year 2008 marked a major shift owing to a significant decline in capital transactions in comparison to previous years. Therefore, this paper first examines the conditions of 2007.

Figure 3 shows a breakdown of international transactions in 2007 that were prepared based on the IMF balance of payments data. Merchandise exports

9) Factors other than the friction among blocs also contributed to World War II. Each bloc had relationships based on dominance by the principal countries and the subordination of neighboring countries. The Greater East Asia Co-prosperity Sphere is one extreme case of such examples based mainly on invasion by a principal country. This type of relationship strongly shaped the characteristics of the war.

10) Although the global recession in 1974 to 1975 was of such a magnitude that it could be viewed as a global depression, the Fourth Arab-Israeli War and the oil shock should be regarded as factors in the recession. Economic depression is often linked to the occurrence of wars as evident in the 1920 economic depression. However, global economic crises after the Lehman Shock can be assumed to have weak correlations with the effects of non-economic factors.

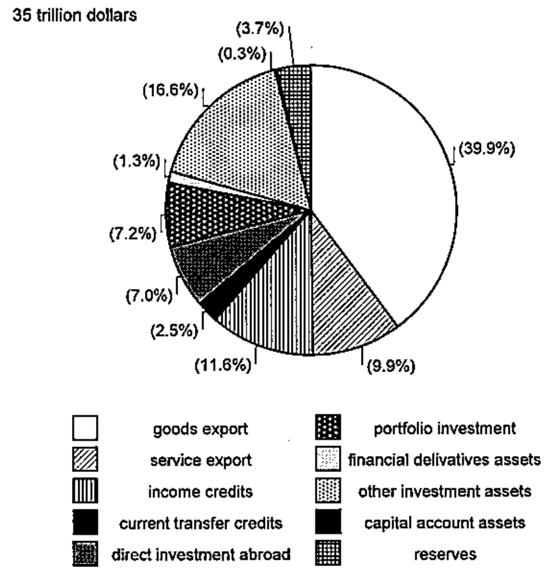

Figure 3. The Composition of International Transactions in the Balance of Payments Statistics of IMF (2007)
Source; IMF [2009a] Part 2, pp. 13, 86.

accounted for approximately 40% of the entire transactions, while service exports accounted for about 10%. Of the transactions, 65.5% originated from current transactions, which consist of these two categories, and income (11.9%) and current transfers (2.6%). The remaining transactions comprised capital transactions. Led by "other investment," which accounted for 16.1% of capital transactions, other items included portfolio investment (7.4%) and direct investment (7.2%).

Next, this paper analyzes the change in the composition of transactions in recent years. As Figure 4 shows, a clear trend may not necessarily be detected because of the undulating changes in the ratio of merchandise exports. However, it still confirms a decline in the ratio of merchandise exports and an increase in that of capital exports to some extent. The capital and related transactions accounted for 40% of the overall international transactions, if one adds an increase in foreign exchange reserves and investment income. This represents the recent status of capital movements and its associated items. Yet, it should also be noted that capital movements were inclined to fluctuate more significantly than other transactions.

Unfortunately, the IMF balance of payments data on derivatives are incom-

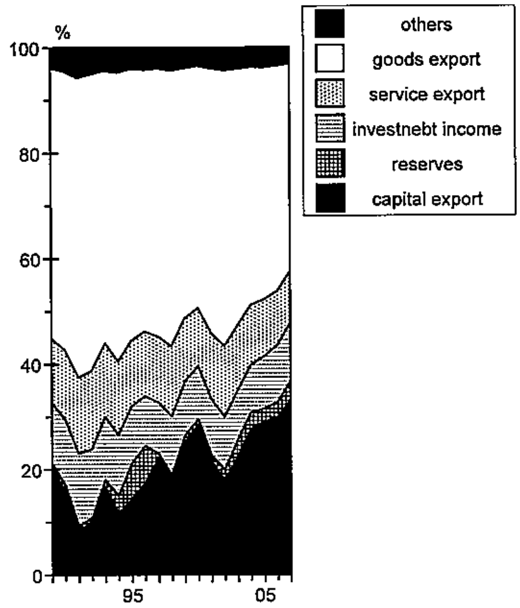

Figure 4. the Recent Change of Share of International Transactions
Source; IMF [1996] Part 2, pp. 3, 12, 36, 52, 56, [2000] Part 2, pp. 9, 18, 42, 58, 62, [2004] Part 2, pp. 9, 22, 58, 82, 88, [2009a] Part 2, pp. 13, 26, 62, 86, 92.

plete.[11] Therefore, this paper examines the capital movements that exclude this item.

With this in mind, what types of changes did the 2008 values show for the global capital movements in keeping with the trend described above? Table 3 suggests that the total investment and reserve assets declined significantly by 9.7 trillion dollars in 2008 compared to the previous year. Most of the decline consisted of decreases in other investment (a decline in 6.5 trillion dollars) and portfolio investment (a decline in 2.4 trillion dollars). The value for the former in 2008 showed a deficit of 691.9 billion dollars, indicating an excess of capital recovery. Additionally, the latter increased by only 98.1 billion dollars. This suggests that a quest to understand the rapid change in capital movements in 2008 should probably focus on "other investment" and "portfolio investment."

First, portfolio investment will be analyzed. Table 4 shows a summary of the aggregated global portfolio investment from 2002 to 2007. The table depicts that developed countries accounted for more than 90% of exports and imports.

11) Although the IMF balance of payments data show the figures for the entire world, they provide only partial data for each country.

Table 3. the Reduction of Global Capital Export (billion dollars)

	2007	2008	defference
direct investment assets	2,437	2,107	−330
portfolio investment assets	2,501	98	−2,403
other investment assets	5,781	−692	−6,473
reserves	1,290	762	−528
total	12,009	2,275	−9,734

Source; IMF [2010] Part 2, p. 13.

Table 4. Grobal Portfolio Investment (the sum of 2002-2007, %)

	assets	liablities
total (billion dollars)	11,986	15,718
developed countries	92.2	95.1
the U.S.A.	12.5	31.5
Japan	6.9	5.3
EURO Area	44.5	40.5
United Kingdom	7.6	8.6
others	20.8	9.1
developing countries	6.1	4.2

Source; IMF [2009] Part 2, p. 104.

Therefore, this analysis does not take developing countries into consideration.[12] Although countries in the Eurozone[13] occupy the top spot for exports and imports, the position of the United States also deserves attention. While the U.S. accounted for 12.5 of exports, it was responsible for 31.5% of imports. Simply put, more than 30% of the global portfolio investment imports were accounted for by one nation during these years. Under such circumstances, a prediction would not be significantly off target if it assumed that the backflow of capital movements in 2008, as described previously, actually occurred primarily in the U.S.

Next, other investment will be examined. Developed countries accounted for approximately 90% of the exports and imports, as suggested in Table 5, which illustrates the aggregate of these items from 2002 to 2007. Although the presence

12) Portfolio investment shows a significant discrepancy between the total export amount and the total import amount. Along with normal statistical variances, this probably means that relatively many values corresponding to an increase in reserve assets are included.

13) The Eurozone in this paper consists of the following nations: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Table 5. Grobal Other Investment (the sum of 2002-2007, %)

	assets	liablities
total (billion dollars)	16,096	16,223
developed countries	89.7	90.3
the U.S.A.	13.3	16.9
Japan	2.0	0.8
EURO Area	37.4	42.3
United Kingdom	26.4	26.3
others	10.7	3.9
developing countries	9.9	8.6

Source; IMF [2009] Part 2, p. 119.

Table 6. the Increase of Grobal reserves (the sum of 2002-2007, %)

total (billion dollars)	4,117.2
developed countries	19.2
the U.S.A.	–0.4
Japan	11.8
EURO Area	–1.2
others	9.0
developing countries	80.5
Asia	41.5
China Mainland	31.9
middle east	12.8
others	26.3

Source; IMF [2009] Part 2, pp. 128-130.

of developing countries is a little higher than in portfolio investment, excluding these nations for the time being would not have a significant impact on this analysis. First, Britain has some interesting trends. The country imports more than one-fourth of the world's other investment, while exporting an almost equivalent volume. While the Eurozone accounts for more than one-third of global exports, the ratio of imports is more than 40%, exceeding that of exports. In the U.S., the exports and imports amount, respectively, to 13.3% and 16.9%. The United States is second in importance, after the Eurozone, in matters related to an excess of imports. The findings above and the capital movements backflow discussed previously suggest that the Eurozone, Britain, and the United States are the most likely to be affected when it comes to other investment.

So far developing countries have not played a significant role in the past in global capital movements. The situation is, however, completely different with regard to the global reserve assets. Table 6 shows that developed nations and developing countries accounted for 20% and 80%, respectively, of the 4.1 trillion dollars increase in aggregated global reserve assets from 2002 to 2008. Yet, Japan accounted for more than half of the increase by developed countries, whereas the figure for the U.S. and the Eurozone was negative. On the other hand, Asian nations, particularly mainland China, accounted for more than half of the increase by developing countries. This signifies that one distinctive aspect of today's global capital movements is the prominent role played by developing countries in the increase of the reserve assets.

Capital movements have been of increased significance in recent global economic activity. When one factors in investment income and the increase of reserve assets, capital transaction exceeds 40% of the overall economic activity, according to the IMF balance of payments data. Moreover, the rapid contraction of capital movements were the most notable change with the global economic crisis. This trend is particularly conspicuous in the areas of "other investment" and "portfolio investment." Capital movements of both investments occurred primarily in the developed countries, namely, the United States, Britain, and the Eurozone. The next section analyzes how the capital movements changed with regard to the United States, during the financial crisis precipitated by that country.

3. The Onset of the Financial Crisis and the Backflow of Capital Movements involving the United States

(1) From the Subprime to Financial Crisis

The worldwide economic meltdown is widely believed to have originated with the subprime mortgage issue, which comprised only a part of U.S. housing finance. This paper will not examine the crisis in detail because a large volume of literature is already available on the subject that agrees on the reasons for those developments. Similarly, the literature also agrees that the U.S. financial crisis induced by the subprime mortgage issue led to the global financial crisis.[14] As

14) The global financial crisis spread worldwide after Lehman Brothers filed for Chapter 11 bankruptcy protection on September 15, 2008. The Lehman Shock triggered off successive generations. The question has to do with why the U.S. government did not rescue this large investment bank. A memoir written by then-

many scholars have indicated, securitization or asset securitization and derivatives associated with such played a significant part in the crisis.[15]

This section cannot conduct a thorough analysis on the details of complex securitization. However, one important aspect that should be addressed is the assumption that the issue was solved through securitization, whereas it was not actually resolved in the end. The following quotation explains the thinking: "In the past, banks had held home mortgages until they were paid off, which meant they were financing long-term mortgage loans with short-term demand deposits. This 'lending long and borrowing short' destabilized banks." "Securitization solved that problem by allowing banks to move mortgages off their books in exchange for upfront cash." (Engel and McCoy, [2011], p. 18)

Regarding the phenomenon that triggered the financial crisis, Henry Paulson, Jr. makes the following statement in his memoirs: "These entities [SIVs: Structured Investment Vehicles] borrowed heavily in short-term markets to buy typically longer-dated, highly rated structured debt securities-CODs and the like. To fund these purchases, these SIVs typically issued commercial paper, short-term notes sold to investors outside of the banking system. This paper was backed by the assets the SIVs held; although the SIVs were frequently set up as stand-alone entities and kept off banks' balance sheets, some maintained contingent lines of credit with banks to reassure buyers of their so-called asset-backed commercial paper, or ABCP." "Financing illiquid assets like real estate with short-term borrowings has long been a recipe for disaster, as the savings and loan crisis of the 1980s and early 1990s demonstrated. However, by 2007, several dozen SIVs owned some $400 billion in assets, bought with funds that could disappear virtually overnight. And disappear these funds did-as investors refused to roll loans

Secretary of the Treasury Henry M. Paulson, Jr. is of interest. First, he describes the situation concerning the federal takeover of Fannie Mae and Freddie Mac, home loan mortgage corporations called GSEs (government-sponsored enterprises), on September 7, 2008. "From the moment the GSEs' problems hit the news, Treasury had been getting nervous calls from officials of foreign countries that were invested heavily in Fannie and Freddie" (Paulson, Jr. [2011], p. 159). He also mentioned, "Japanese and Chinese central bankers had applauded" (*ibid.*, p. 171) when these corporations were put under federal control. Haruhiko Kuroda, former director-general of the International Finance Bureau and vice minister of Finance for International Affairs at the Ministry of Finance, stated that "the collapse of both corporations was believed to have serious effects on the international finance system since the six trillion dollar debentures issued by them were globally held in foreign currency reserves" (Kuroda [2010], p. 22). Moreover, he described the rescue of AIG one day after the Lehman Shock as follows. "The company's immediate difficulties stemmed from the fact that it had written huge amounts of credit default swap insurance on obligations backed by mortgages" (Paulson, Jr. [2011] p. 205). "Tim [Geithner, then-president of the Federal Reserve Bank of New York] and I knew that an AIG bankruptcy would be devastating, leading to the failure of many other institutions" (*ibid.*, p. 218). This confirms that government authorities felt that Lehman Brothers at least did not present such a risk.

15) Besides Paulson, Jr. [2011]), also refer to McDonald [2009] and Sorkin [2009], and so on, for the facts and developments.

over even when they appeared fully collateralized. The banks like Citi that stood behind the SIVs now faced a huge potential drain on their capital at just the moment they had to contend with a liquidity crunch." (Paulson, Jr. [2011] pp. 70-71)

Although the details of securitization are acknowledged to be complex, the basic pitfall of the concept is that it was not able to overcome the instability of "lending long and borrowing short." It established global chains that continued to expand while entangling several interested parties in increasingly complex arrangements. This led to the recent historic collapse that triggered the prolonged economic crisis. The backflow of the capital movements involving the U.S. occurred under such circumstances.

(2) Trade Reduction

This section begins by analyzing the U.S. balance of payments in recent years. Figure 5 depicts a dramatic decline in the current account balance deficits and the financial account balance surpluses by comparing the data for 2009-when the contagion of the financial crisis was spreading relentlessly around the world-and those for previous years. The rapid decline in the former can be attributed mainly

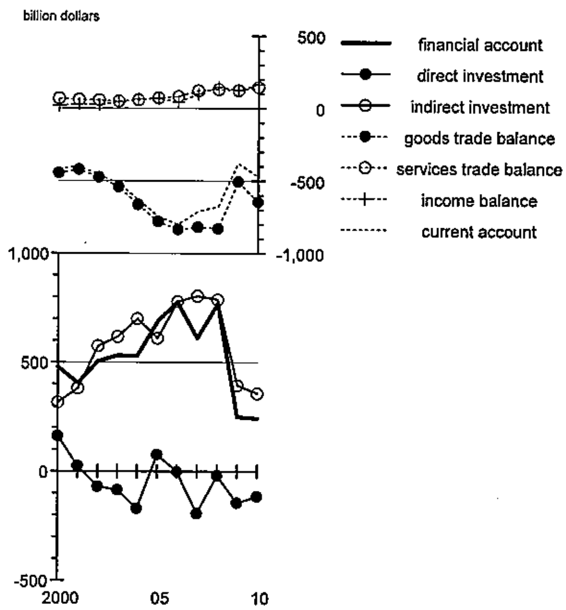

Figure 5. Recent Balance of Payments of the U.S.. The indirect investment consists of portfolio investment and other investment, hereafter.
Source; U. S. Department of Commerce [2011a] pp. 70-71.

to changes in the trade balance, since no significant shifts in the trends in service and income surpluses can be observed. On the other hand, a considerable decrease in the financial account balance surpluses can be explained definitively by a decline in "indirect investment (i.e. portfolio and other investment)" other than "direct investment."

Let us analyze the change in the trade balance. The year 2009 saw the emergence of some types of reverse phenomenon in the U.S. trade balance.[16] Table 7 compares data on trade balance, export amounts, and import amounts by region with those of the previous year. Table 7 (1) illustrates that other regions and the Asia/Pacific Region, primarily China/Hong Kong, accounted for one-fourth and one-fifth, respectively, of the 324.2 billion dollars of the declining trade balance deficit, while Canada accounted for 17.8% of the deficit. This suggests that the European region, the largest export region for the U.S., did not play a significant role in this shift. However, both exports and imports need to be analyzed since this examination focuses only on the trade balance.

As Table 7 (2) shows, Europe (mainly the EU), Canada, and the western hemisphere region account for 28.6%, 23.9%, and 21.3%, respectively, of the total reduced export amount of 238 billion dollars, indicating a demand reduction in these regions. Under these circumstances, the Asia/Pacific region experienced only about 10% of export reduction because of a minimal decline in exports to China/Hong Kong; other regions experienced the same. These regions deserve some attention. Table 7 (3) shows that the ratios of Europe and Canada accounted for a large portion of the 562.2 billion dollar decline in American imports. At the same time, it shows the Asia/Pacific region accounted for a large percentage of the decrease in imports proportionate to the decline in export amounts.

These findings suggest that the regional differences seen in the decline of the trade balance deficit were owing to the varying reductions in each region's export and import amounts. The U.S. trade balance declined from 2008 to 2009 because of decreases in exports and imports with other regions. In other words, differences in the declines of mutual trade were observed, so that a decline in exports to Europe, Canada, and the western hemisphere was larger than that in imports from these regions, while the opposite occurred in trade with the Asia/Pacific

16) The balance of payments shows no significant changes in the trade balance from 2007 to 2008. For instance, exports and imports in 2007 were 1.1640 trillion dollars and 1.9828 trillion dollars, respectively, with a trade deficit of 818.9 billion dollars. These figures in 2008 are 1.3075 trillion dollars and 2.1376 trillion dollars for exports and imports, respectively, with a trade deficit of 830.1 billion dollars (U. S. Department of Commerce [2011a] p. 71).

Table 7. the U.S. goods trade

(1) balance (million dollars)

	① 2008	② 2009	②−①	%
total	−830,109	−505,909	324,200	100.0
Europe	−114,882	−69,203	45,679	14.1
EU	−95,239	−58,166	37,073	11.4
others	−19,643	−11,037	8,606	2.7
Canada	−79,358	−21,718	57,640	17.8
Japan	−75,215	−44,817	30,398	9.4
Asia/Pacific	−334,195	−267,245	66,950	20.7
China/Hong Kong	−252,397	−209,119	43,278	13.3
others	−81,798	−58,126	23,672	7.3
Western Hemisphere	−92,462	−49,422	43,040	13.3
others	−133,997	−53,504	80,493	24.8

(2) value of goods export (million dollars)

	① 2008	② 2009	②−①	%
total	1,307,499	1,069,491	−238,008	100.0
Europe	331,868	263,849	−68,019	28.6
EU	277,172	225,320	−51,852	21.8
others	54,696	38,529	−16,167	6.8
Canada	262,282	205,457	−56,825	23.9
Japan	67,178	52,937	−14,241	6.0
Asia/Pacific	262,164	238,546	−23,618	9.9
China/Hong Kong	94,148	92,552	−1,596	0.7
others	168,016	145,994	−22,022	9.3
Western Hemisphere	289,785	239,204	−50,581	21.3
others	94,222	69,498	−24,724	10.4

(3) value of goods import (million dollars)

	① 2008	② 2009	②−①	%
total	2,137,608	1,575,400	−562,208	100.0
Europe	446,750	333,052	−113,698	20.2
EU	372,411	283,486	−88,925	15.8
others	74,339	49,566	−24,773	4.4
Canada	341,640	227,175	−114,465	20.4
Japan	142,393	97,754	−44,639	7.9
Asia/Pacific	596,359	505,791	−90,568	16.1
China/Hong Kong	346,545	301,671	−44,874	8.0
others	249,814	204,120	−45,694	8.1
Western Hemisphere	382,247	288,626	−93,621	16.7
others	228,219	123,002	−105,217	18.7

Source; U. S. Department of Commerce [2011a] pp. 76-78.

region and other regions. This implies the presence of a channel by means of which the economic crisis spread internationally from the U.S. throughout the trading areas. Additionally, it should be noted that annual data show such trade declines were conspicuous in 2009, because of the disturbances caused by the backflow of capital movements.

(3) Backflow of Capital Movements

Table 8 categorizes the assets and liabilities of the U.S. financial account into direct and indirect investment and then examines the trend in these. The data show that a significant change occurred in 2008. In other words, the asset category recovered the 337 billion dollars from the 1.5 trillion dollars outflow whereas the liability category saw a significant decline in the inflow of 431.4 billion dollars from that of 2.1 trillion dollars. Moreover, indirect investment clearly played a major role in these changes. Therefore, this section primarily focuses on indirect investment, rather than direct investment.

The following sections analyze the trend in indirect investment by region. However, the U.S. Department of Commerce uses significantly different classifications for the balance of payments by region until 2004 and after 2005. With this in mind, this section first examines the aggregated values from 2000 to 2004 and then analyzes the data for 2005 and each of the subsequent years. Table 9 shows the aggregated the U.S. foreign assets and liabilities by region from 2000 to 2004. A majority of the U.S. capital described as assets flowed out to Britain and other Europe, then to the western hemisphere region. Moreover, foreign capital described as liabilities flowed into the country, mainly from Britain, the western hemisphere, and other European nations.

Further, the trend after 2005 will be analyzed. Table 10 shows the data on the assets. Europe (mainly Britain) and the western hemisphere remained as major

Table 8. Recent Financial Account of the U.S. (million dollars).

	2000	01	02	03	04	05	06	07	08	09	10
total assets	-560,233	-377,705	-290,965	-326,947	-1,003,675	-560,727	-1,288,103	-1,453,482	336,957	-87,074	-1,003,348
direct investment	-159,212	-142,394	-154,460	-149,564	-316,223	-36,235	-244,922	-414,039	-329,081	-303,606	-351,350
indirect investment	-401,021	-235,311	-136,505	-177,383	-687,452	-524,492	-1,043,181	-1,039,443	666,038	216,532	-651,998
total liabilities	1,038,224	782,870	795,161	858,303	1,533,201	1,247,347	2,065,169	2,064,642	431,406	335,793	1,245,736
direct investment	321,274	167,021	84,372	63,750	145,966	112,638	243,151	221,166	310,092	158,581	236,226
indirect investment	716,950	615,849	710,789	794,553	1,387,235	1,134,709	1,822,018	1,843,476	121,314	177,212	1,009,510

Source; *ibid.*, pp.70-71.

Table 9. the Sum of the U.S. indirect investment from 2000 through 2004 (million dollars). In this table, Western Hemisphere dose not include Canada, and Asia/Africa dose not Japan.

	assets	liabilities
total	–1,578,942	4,192,804
United Kingdom	–812,279	1,149,752
other Europe	–174,805	998,721
Japan	–115,855	521,332
Canada	–51,540	99,801
Western Hemisphere	–386,784	1,074,926
Asia/Africa	–6,247	462,857
others	–31,432	–114,585

Source; U. S. Department of Commerce [2002] pp. 50-51, 78-83, [2003] pp. 58-59, 104-109, [2004] pp. 76-77, 106-111, [2005] pp. 82-83, 112-117.

Table 10. Recent indirect investment assets of the U.S. (million dollars). In this table, Western Hemisphere dose not include Canada, and Asia/Africa dose not Japan.

	2005	06	07	08	09	10
total	–431,825	–822,192	–956,461	336,754	180,471	–651,998
Europe	–214,580	–562,323	–760,493	355,174	193,351	–57,852
United Kingdom	–94,739	–397,111	–394,329	509,399	33,078	–162,658
others	–119,841	–165,212	–366,164	–154,225	160,273	104,806
Japan	–41,820	–42,038	64,243	–83,781	47,441	–119,213
Canada	–36,881	–39,590	–44,406	–6,023	–52,767	–100,665
Asia/Pasific	–37,541	–25,750	–27,035	58,548	–96,258	–112,817
China/Hong Kong	–11,828	–8,886	7,488	47,882	–4,032	–45,329
others	–25,713	–16,864	–34,523	10,666	–92,226	–67,488
Western Hemisphere	–12,198	–66,123	–178,057	–19,347	112,812	–260,784
Middle East	–3,487	–4,161	–9,591	19,906	–9,357	4,425
others	–85,318	–82,207	–1,122	12,277	–14,751	–5,092

Source; U. S. Department of Commerce [2006] pp. 62-63, 98-104, [2007] pp. 66-67, 100-106, [2008] pp. 66-67, 98-104, [2009a0] pp. 66-67, 96-102, [2010a] pp. 62-63, 92-98, [2011a] pp. 70-71, 100-106.

outflow destinations for U.S. assets until 2007. However, the trend was reversed in 2008. The overall data for 2008 and 2009 suggest an excess of capital recovery, especially from Britain in 2008 and from other European countries in 2009. This trend of an excess of capital recovery from the western hemisphere region can also be observed in 2009.

Table 11 illustrates the data on the liabilities. An inflow from the western hemi-

Table 11. Recent indirect investment liabilities of the U.S. (million dollars). In this table, Western Hemisphere dose not include Canada, and Asia/Africa dose not Japan.

	2005	06	07	08	09	10
total	1,102,496	1,679,017	1,820,161	214,334	171,029	1,009,510
Europe	492,183	654,272	904,887	–480,225	–235,376	326,118
United Kingdom	269,594	508,685	615,884	–369,212	–110,418	356,749
others	222,589	145,587	289,003	–111,013	–124,958	–30,631
Japan	46,507	26,268	39,426	84,198	26,172	148,912
Canada	71,871	50,594	36,767	22,880	39,623	112,638
Asia/Pasific	278,976	301,610	318,258	483,835	303,289	263,074
China/Hong Kong	223,899	247,301	283,740	462,186	223,865	126,276
others	55,077	54,309	34,518	21,649	79,424	136,798
Western Hemisphere	29,085	181,993	477,305	–3,157	–42,430	124,899
Middle East	17,379	53,034	35,501	74,080	6,777	–3,097
others	166,495	411,246	8,017	32,723	72,974	36,966

Source; same as Table 10.

sphere region and the Asia/Pacific region (such as China/Hong Kong) was conspicuous until 2007, with Europe, particularly Britain, playing a central role. Then, major changes occurred in 2008 and 2009, so that there was a drastic decline in the total liability amount owing to an excess of withdrawal by Europe, including Britain and the western hemisphere region. Yet, this did not create an overall excess of recovery, because of continuous inflows from the Asia/Pacific region. As these findings indicate, a clear backflow phenomenon of capital movements from Europe (mainly from Britain) of both assets and liabilities in indirect investment could be observed as the financial crisis in the U.S. emerged.

(4) Derivatives

The U.S. government has released data that show the status of international derivatives transactions after 2005.[17] Analyzing the data is a matter of urgency, as the focus has turned to the role played by derivatives in this economic crisis. Caution is, however, required when treating derivatives containing elements different from normal assets and liabilities in the same way as general capital movements.[18] The data to be used in this section focus on the cash flow associ-

17) Bach [2007], [2008], U.S. Department of Commerce [2009b], [2010b], [2011b], Nguyen [2011].

18) Refer to Bach [2007] and Curcuru [2007] for more on this matter.

Table 12. the Composition of the U.S. International Invesment Position (yearend, %)

	2000	07	10
net position (billion dollars)	–1,337	–1,796	–2,471
total assets (billon dollars)	6,239	18,400	20,315
Financial derivatives	—	13.9	18.0
US official reserve assets	2.1	1.5	2.4
US other official assets	1.4	0.5	0.4
private direct investment	24.6	19.3	21.8
private holding foreign securities	38.9	37.1	30.6
banking sector assets	19.7	20.9	22.5
private other assets	13.4	6.7	4.3
total liabilities (billion dollars)	7,576	20,196	22,786
Financial derivatives	—	12.3	15.5
US Treasury securities held by foreign government	10.0	12.6	14.6
foreign government other assets	3.7	4.3	6.8
direct investment	18.7	11.6	11.7
US Treasury securities	5.0	3.2	4.7
other US securities	34.6	30.6	25.7
banking sector liabilities	15.4	19.7	16.3
other liabilities	12.5	5.6	4.8

Source; U.S. Department of Commerce [2011c] pp. 122-123.

ated with derivative transactions; the recipients are taken as “positive” with the fair value shown as the balance for the asset and the payers are taken as “negative” with that value shown as the balance for the liability.

The analysis in this section aims only to understand the general structure of the issue within the framework of this paper, which examines the effects of the spread of the economic crisis internationally, from the standpoint of capital movements backflow. First, this section checks the status of derivatives, which account for the U.S. international investment position. As Table 12 suggests, derivatives accounted for 18% and 15.5% of the assets and the liabilities, respectively, at the end of 2010. The emergence of derivatives and their increased ratio reduced the share of private and other assets and the private holdings of foreign securities on the asset side, as well as securities other than the U.S. Treasury securities on the liability side.

Table 13 shows changes in the derivatives balance. While the balance for both assets and liabilities rapidly expanded, beginning at the end of 2005, it declined by almost half of the previous year end at the end of 2009. With this in mind,

Table 13. Financial Derivatives Gross Positive and Negative fair Value
(yearend, billion dollars)

	2005	06	07	08	09	10
gross positive fair value	1,190	1,239	2,559	6,127	3,500	3,652
gross negative fair value	1,132	1,179	2,487	5,967	3,366	3,542
net	58	60	72	160	134	110

Source; Nguyen [2011] pp. 122-123.

Table 14. the Composition of the U.S. Gross Fair Value of Financial Derivatives by Area
(yearend, %)

(1) positive fair value

	2006	07	08	09	10
total (billion dollars)	1,239	2,559	6,128	3,501	3,653
Europe	84.6	87.1	90.8	91.2	91.3
EU	82.0	83.8	88.5	87.0	88.8
EURO Area	28.2	22.4	20.4	20.1	20.0
United Kingdom	53.2	60.9	67.9	66.7	68.5
Canada	2.6	2.0	1.5	1.3	1.3
Caribbean financail centers	5.4	5.2	3.0	2.2	2.0
Asia	4.7	4.0	3.8	3.7	3.8
Japan	3.1	2.6	2.3	2.6	2.9
others	2.8	1.6	0.9	1.7	1.5

(2) negative fair value

	2006	07	08	09	10
total (billion dollars)	1,179	2,488	5,968	3,366	3,543
Europe	84.3	87.4	91.1	91.7	91.5
EU	81.7	84.2	89.0	90.1	89.1
EURO Area	27.4	22.1	20.0	19.8	19.1
United Kingdom	53.6	61.7	68.6	70.0	69.7
Canada	2.3	1.8	1.5	1.2	1.8
Caribbean financail centers	6.2	5.3	2.8	1.7	1.4
Asia	4.5	4.0	3.7	3.7	3.9
Japan	3.1	2.7	2.4	2.7	3.0
others	2.7	1.5	0.9	1.7	1.4

Source; Bach [2008] p. 48, U. S. Department of Commerce [2009b] p. 50, [2010b] p. 104, [2011b] p. 112.

Table 14 shows the following changes in both assets and liabilities by region. The table illustrates that both sides share the same general trend. In other words, the dramatic decline at the end of 2009 occurred at the same time the trend in an increased ratio for Europe, primarily Britain, started to emerge.

As explained above, the trend in derivatives while the crisis was spreading worldwide is almost equivalent to that in indirect investment discussed previously. Yet, the difference lies in the fact that derivatives are more strongly connected to Europe, particularly Britain, and that the contraction of derivatives did not begin until the end of 2008; as the trend in capital movements shows, this similar trend was also confirmed for derivatives. Hence, it is reasonable to compare this global economic crisis to the Great Depression and the subsequent global depression.

Conclusion

Then-U.S. Secretary of the Treasury, Henry Paulson, Jr., at the time of the Lehman Shock, stated, "The market is ready to collapse" (Paulson Jr. [2011], p. 254,). The chairman of the Federal Reserve, Ben Bernanke, said, "It is a matter of days before there is a meltdown in the global financial system" (*ibid.*, p. 259). They tackled this economic crisis with a strong sense of urgency, which efforts likely prevented a repeat of the global depression of the 1930s.

Moreover, there were no comparable factors in this economic crisis, such as reparations/war debt issues and a worldwide agricultural recession that significantly exacerbated the instability of the global economy during the interwar period. International cooperation during the 1930s was also fragile as evident by the breakdown of the 1933 World Economic Conference in London. Even if such cooperation were established, it would have been fruitless in the face of the historical turbulence. Countries around the world cooperated with one another to deal with the current crisis, indicating that international communities have learned some lessons from history. Additionally, policies implemented by each country reflect knowledge gained from the bitter experience of the 1930s.

On another note, the current global economy is also entering an unknown era. If the descriptions "once in every 100 years" and "since the Great Depression" are correct, the world is witnessing an unprecedented phenomenon in which the global economy has been moving forward without experiencing any catastrophic collapse. This means that international communities lack precedents on which to base guiding principles and will be forced to move ahead with uncertainty.

The collapse of the global economy in the 1930s brought misery and demanded tremendous sacrifices. However, it also led to significant economic and institutional reforms, as countries resolved not to repeat earlier mistakes. Although the policies currently being implemented may assist in preventing the expansion and exacerbation of the economic crisis to a certain extent, they are far from being effective to solve the following structural problems.

"In retrospect, the crisis that struck in August 2007 had been building for years. Structural differences in the economies of the world had led to what analysts call 'imbalances' that created massive and destabilizing cross-border capital flows. In short, we were living beyond our means-on borrowed money and borrowed time." (ibid., p. 64).

If this statement is true, the global economy would be required to deal with the instability caused by international capital movements for some time to come.

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