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International Economic Factors and Crises

Mirjeta Domniku
University for Business and Technology, mirjeta.domniku@ubt-uni.net

Lorik Elezkurtaj
University for Business and Technology - UBT

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Mirjeta Domniku[1], Lorik Elezkurtaj[2]
[1,2] Faculty of Management, Business and Economcs, UBT – Higher Education Institution
Lagja Kalabria, 10000 p.n., Pristina, Kosovo

{mirjeta.domniku[1], le41243[2]}@ubt-uni.net

Abstract. Economics is a topic that initially does not arouse curiosity, in appearance it is a profession which seems very dull and routine, with this paper we will try to prove the opposite, that economics is a topic that will grip anyone studying it with its magic. Economics functions like nature itself, things in it sometimes happen even when we do not pay attention. As the nature is in constant motion so is the global economy, these motions create fluctuations which in turn create social fluctuations which can lead to instability and unrest, as a result of this we must ensure we analyze each crisis with the utmost care in order to fully understand these economical fluctuations. After reviewing the literature and analyzing each factor we can conclude that economic crises are created in two ways: created as a result of human actions which in most cases can be prevented if the factors leading to these crises are identified in time and crises created as a result of situations which are beyond our control such as cases of natural disasters which cannot be prevented but managed.

Keywords: Economy, crisis, factors, states, society, credit, money, banking.

1. Introduction

The world today is a place completely different from the past, a more creative and dynamic place in every aspect, from the economy to the arts and to the way people think and behave in their daily lives. This paper will focus on the topic of global economics, consequently the main purpose of this paper is to create an adequate understanding of the factors which affect the global economy. Economic systems however primitive have always existed throughout the history of mankind. These economic systems in their early days were relatively simple, in the ancient period it encompassed a small community which exchanged basic goods with each other, and then later as the mankind developed both technologically and culturally so did the economic systems, from industrialization to the present modern era. As economics has always influenced man and society we should consider the study of economics as important. With this paper we will try and answer some of the basic questions about economic fluctuations, crisis and factors that have contributed in various cases which have occurred previously. The Great Depression, The Financial Crisis of 2008 and The Recession from Covid-19, are topics which will give us a deeper understanding of the true role of such crisis in our lives.

2. Literature Review

2.1 The Economy and Crises

A word which may seem very intimidating and complicated as a subject to the ordinary reader, but in fact a very simple concept or system based on logic and information. "Economics is defined as a social field that emphasizes material practices, discourses, and expressions related to the production, use, and management of resources" (James, Magee, Scerri, & Steger, 2015, p. 53). Crises come in many forms, they can come in the form of price changes in a market, financial crises, depressions, banking crises, currency crises, speculative bubbles, natural causes, pandemics, and so on. A crisis means a fluctuating period of time which is manifested by lower economic activity during which there may be large losses in the value of assets, jobs, production, monetary value, etc. Many economists at different times have given different theories on how to prevent economic crises, despite this fact there is still no specific comprehensive theory and economic crises continue to occur from time to time.

2.2 The Great Depression in the US

The Great Depression in the US was an extended period of recession during the years 1929-1940 which had major consequences for the US economy. Milton Friedman (1962) based on his analysis he concludes that the Great Depression was not necessarily due to the October 1929 stock market crash. He in fact states that the emergence of the "bubble" may have been driven by the rise in the interest rate charged by the United States Federal Reserve on loans to commercial banks. The cause of the speculative bubble that led to the collapse is a somewhat controversial topic. While Friedman acknowledged that the bubble was caused by investors, apparently supporting at least in part the Keynesian explanation. During 1930 the number of banks that went bankrupt was 352 which resulted in several other waves of bank failures. The fact here is that the Great Depression was produced by the mismanagement of government rather than by an internal instability of the economy. (Friedman, 1962, p. 60)

2.3 Financial crisis of 2007-2008

This crisis is fresh in the history of the world, considered by economists as the most influential crisis after the Great Depression. “The crisis began in 2007 with a devaluation in the subprime mortgage market in the United States and developed into an international banking crisis with the collapse of investment bank Lehman Brothers on September 15, 2008” (Williams, 2010, p. 213). The financial crisis of 2007-2008 produced a “domino effect” which shook the foundations of the modern world, due to the level of globalization this crisis also reached Europe and it started the Eurozone debt crisis.

2.4 Recession from the COVID-19 pandemic

The recession that the world entered at the beginning of the 2020 is as a result of a new virus called corona virus (COVID-19). The virus, in addition to spreading across countries, initially spread another "disease" with economic consequences, panic. As a result of widespread panic but also the potential risk of loss of life many countries were forced to take physical quarantine measures for their citizens. These drastic measures had catastrophic consequences, the pandemic is causing the largest global recession in history, with more than a third of the global population at the time being placed in quarantine or restrictions (Morgan McFall-Johnsen, 2020).

3. Methodology

During the compilation of this paper to have an easier understanding, orientation and comparison of data we have used the empirical method associated with qualitative and quantitative data mainly provided by secondary sources. The qualitative method has made it possible for us to analyze the various factors that have influenced different cases to enable the detection of possible trends. The quantitative method which we have obtained mainly via the internet, books and reports makes it easier for us to have a structured analysis of the numerical parts of the factors that have influenced the formation of different crises and situations.

As a source of secondary data we have used multiple articles, books and journals found online and physically which encompass various topics of economics, we made sure to evaluate and use relevant data that represent diverse opinions of various economists.

4. Results

As we go by each chapter and analyze each crisis we come to conclusion that the cause of crises are different, the word "crisis" is a broad term for economic situations often created by the negligence of relevant institutions.

Crisis can be created by various factors such as natural factors, hyperinflation, speculative bubbles, banking crisis, fiscal crisis, currency crisis, supply shocks etc. Most if not all of the crises are caused by the factors mentioned above, which are mainly caused by man and can be avoided in time if there is a good system of governance in place.

Our results are focused on how crises can be avoided by taking as example previously mentioned cases, it is worth to mentioning that crises can be created by natural and sometimes uncontrollable factors, in such cases if prevention fails we must focus on how to best handle a crisis. In cases when the crisis is more widespread as a result of a bigger natural disaster then the recovery is also more difficult because the capacities of a country in such situations become more limited, a broken arm can be healed more easily and with less pain whereas two broken arms and injured legs have greater impact on the body and a slower recovery.

In the case of the Great Depression and the Financial Crisis of 2007-2008, the cause for those crisis was institutional negligence. In the first case, that of the Great Depression the money supply fell by over a third (Friedman & Schwartz, 1963),it was the job of the Federal Reserve to provide liquidity to the market and stop the banks from bankruptcy.

This could have been stopped or minimized if the government intervened in time to provide liquidity and ensure proper functioning of the institution, the latter could have been done by hiring more professionals and thoroughly making evaluations after each decision.

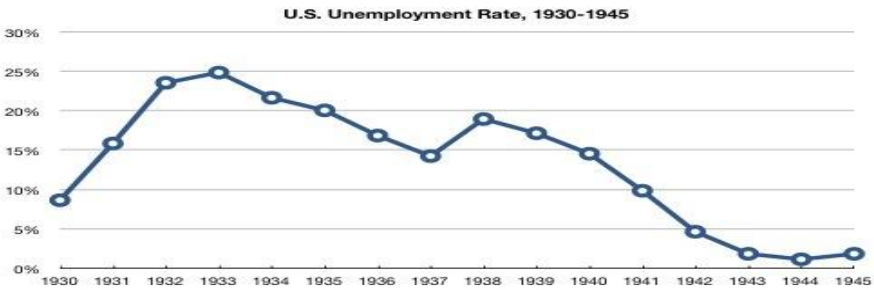

Figure 1. USA Unemployment Rate 1930-1945

(Watkins, 2020)

The great depression in the United States of America created long lasting problems in the economy, it caused rise on unemployment numbers as shown on the data above.

The financial crisis of 2007-2008 was a disaster, it was created by the hand of some greedy individuals whose primary objective was to create profit ignoring the potential risk created by bad credit in the economy, house prices were artificially increased by a huge influx of credit and spending, in the end a small hole in loan repayment was all it took to send the whole system in total chaos.

The Government in the second case could have prevented the Financial Crisis from happening by intervening to stop the unethical practices from happening and ensuring proper function of the regulatory institutions.

In the current case with the pandemic which is still continuing to this day we have a different case something unpredictable, a natural disaster which caused great panic.

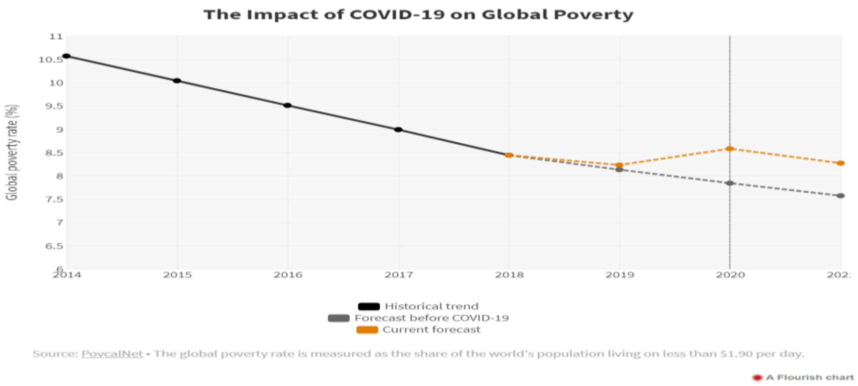

Figure 2. The Impact of COVID-19 on Global Poverty

(Povcalnet, 2020)

In the data above we can observe that the level of poverty in the world was going on a downward trend over the past years, the percentages mean millions lifted from poverty. This trend before COVID-19 was predicted to continue until at least 2022, with the appearance of the virus now the curve appears to take a strong turn and rise to higher levels and cause more people to enter poverty. But on the other hand also the non-implementation of restrictions would also cause more death and suffering, humanity was at a crossroads and none of the roads had a good end. Given the situation already created it is in our opinion that if we were given the opportunity to go back to the beginning once again a third way would have to be found, a middle ground between total closure and total opening in order to minimize the spread of the virus and economic damage. Another consequence of the restrictions caused by the pandemic which was immediately felt afterwards was on the unemployment rate, many companies were forced to lay off their workers as a result of falling demand. The US experienced one of the highest re-registered unemployment rates in its economy.

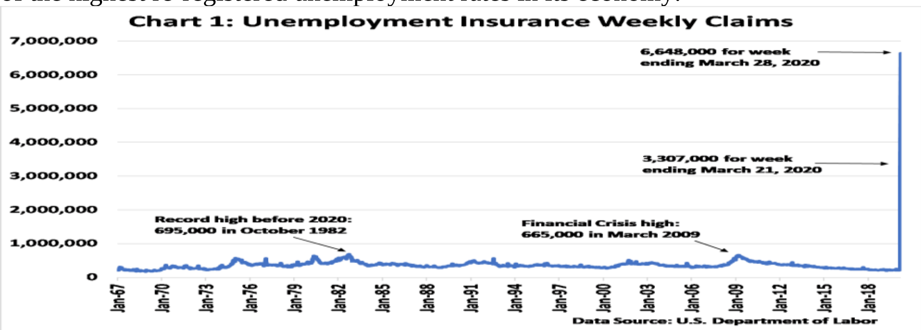

Figure 3. Unemployment Insurance Weekly Claims

(Labor, 2020)

In all of the cases the business cycle is affected which in turn produces economic instability. The business cycle describes the rise and fall of the production of goods and services in an economy (Hayes, 2020). In short it is how we spend our money, the money we spend is someone's wage thus creating an endless cycle which is constantly running. This cycle is also influenced by credit, if within an economy there is more credit spending rises and we have an expansion of the economy, and its only when the credit is paid spending is reduced and thus creating a recession. In cases of crisis this cycle is directly affected, a crisis distorts the cycle and produces an early unexpected recession. So based on this explanation we have a clearer idea on how different factors can influence this cycle.

In order to avoid economic crises in general and to get out of negative business cycles by considering and studying all the factors and earlier experiences we can conclude that the best approach would be by using and balancing between the methods described by Ray Dalio:

• Reducing spending - businesses, government and other economic actors cut spending significantly and pay off debts, this is a deflationary measure
• Debt reduction - in debt restructuring lenders agree to restructure debts in order to save at least some of their capital.
• Redistribution of wealth - the government taxes the rich and distributes wealth to other sectors in need.
• Money printing - when interest rates do not work during periods of recession because borrowers do not want to increase their debt, central banks buy assets and directly finance government debt by issuing money by injecting money into the market. (Dalio, 2013)

5. Conclusions and Recommendations

After reviewing the results, we finally have a clearer idea of how crises are created and what they are, and we also have a clear picture of how they can be prevented through various factors, normally if there is the will of the relevant actors. By avoiding crises and various economic situations, social tensions which are a direct outcome of the crises can also be avoided. Economic prosperity also paves the way for both technological and social developments which in the long run increases the financial, social stability and freedom.

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