

How crisis could have been averted

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 GLOBE AND MAIL UPDATE
 OCTOBER 9, 2008 AT 5:34 PM EDT

OTTAWA — The problem with any crisis is that once it is upon you, all thought of the long term goes out the window, replaced by the need to survive the most immediate threat.

And so it will be at the various emergency conclaves now being convened around the world by politicians and bankers desperate to end the global financial crisis before it claims any more banks.

They will no doubt emerge with complicated plans that average taxpayers won't understand, even though they will be asked to foot what is rapidly becoming an astronomical global bill. Instead of declaring victory and heading home, they should address the problem that led to this debacle in the first place: the lack of transparency in financial markets.

Think back to August, 2007, when the world first became aware of the problem U.S. bankers unleashed on unsuspecting citizens in the form of asset-backed mortgage securities. While the phrase fairly trips off the tongue now, back then few people had heard of this investment concocted in the bowels of the U.S. financial system.

It rapidly became clear that investors buying these securities, who ranged from large financial institutions to couples saving for their retirement, hadn't a clue what they were really buying.

(If you're in need of a good laugh at the moment, as most people with money in the stock market undoubtedly are, I'd recommend viewing a skit by British comedians John Bird and John Fortune on how these securities came into being.)

The serious point is that if full transparency had been demanded of the financial institutions repackaging subprime mortgages, the current crisis might have been averted.

There might still have been investors willing to buy risky securities if the promised return were high enough. But they would have been far fewer in number than those who wound up adding asset-backed mortgage securities to their portfolios, and they would have done so with their eyes open.

Instead, these so-called investments spread far and wide, with most purchasers ignorant of the time bomb they had bought. A rule requiring total transparency at this stage in the process was all that was needed to contain the contagion.

A second opportunity to stop the current madness was missed when it started to dawn on financial authorities around the world that these problem securities had spread well beyond U.S. borders. They knew this from anecdotal evidence as individuals, companies and financial institutions started complaining, rather than any concerted effort to nail down how many of these securities had been sold and to whom.

Imagine if there had been a concerted, co-ordinated global effort in the summer of 2007 to have the sellers and the buyers come clean about their holdings. It would have been difficult, but surely not impossible. And it would have revealed once and for all the most troubled financial institutions.

Sadly this did not happen and the crisis entered its latest and most damaging phase where financial institutions were afraid to lend or borrow from each other, causing global credit markets to seize up. With total transparency, this lack of trust would have been avoided. But as none was demanded, none was given.

It is only now, when banks in the U.S. and Europe (but not Canada I might underline) are toppling like dominoes, that politicians and bankers are seized with the need to meet and come up with some global response.

The actions to date are stop-gap measures that contain the seeds of further crises down the road. When the U.S. government decides to spend \$700-billion (U.S.) it does not have to bail out Wall Street it only worsens an already dire financial position.

Even this week's co-ordinated cut in interest rates by a number of central banks is likely to lead to more problems. As one Bank for International Settlements official said this summer when speaking about the management of financial crises: "More credit cannot forever be the answer to problems brought on by excessive credit growth in the first place. The eventual outcome must then be a still larger crisis."

All the effort in the coming days and weeks by policy makers will be to stop the current situation from becoming worse. That is indeed necessary. But they will do their taxpayers' a disservice if they do not also put in place some safeguards for the future.

Insisting on transparency in financial markets is one such step. If we'd had more of it in the first place we wouldn't be in the mess we are in now.

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