

The World in a Flux

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Sherman Tan

A Major Ethical Gap

In less than 3 weeks after the world has witnessed the spectacular Beijing 2008 event, the world was astonished to learn that a major state-owned joint venture with a New Zealand dairy co-operative was involved in a tainted milk scandal that affected more than 54,000 children across the nation. What was more disturbing is that milk tainted with melamine; a chemical illegally introduced to increase detection of nitrogen; a test to establish presence of protein in food products is used in the manufacturing of other dairy food products that are exported to other parts of the world. Of greater concern is that initial news of infants falling ill after consuming the contaminated infant formula surfaced as early as March this year but there was no formal action on these complaints by Sanlu, the main company involved in the scandal.

While China has recalled the contaminated milk related products from a number of countries; a World Health Organisation spokesperson was reported as saying that the organisation is not sure how many countries are affected by the tainted milk products and has warned against tainted milk products being smuggled across borders.

Although China Premier, Wen Jiabao has publicly apologized to the nation for the lapse and the central government has promised to pay all medical costs to treat those affected by the contaminated milk products, there was public outcry on the inadequacy of safety testing and inspection on food products. To assured the public and restore trust in China products, the Chinese Premier said "What we need to do now is to ensure that nothing like this happens in the future, not only in dairy products, but in all foods," he said. "Manufacturers and owners of dairy companies should show more morality and social responsibility in these cases. They are heartless, so we have to create strict law and legislation. I'm sorry."

Fall of the Giants

While China and those countries that imported dairy products from China grappled with the tainted milk scandal, Lehman Brothers, the fourth largest investment bank in the United States filed for bankruptcy on 15 Sep 08. This came shortly in the heel after the US Federal Reserves was forced to step in to shore up the finances of Fannie Mae and Freddie Mac with US\$100 Billion a week earlier.

As stock markets around the world took a free fall after Lehman's bankruptcy news broke out, one day later; news of American International Group (AIG), the world's largest insurance company and a big issuer of credit default swaps was reported as being on the brink of bankruptcy shook the world. Soon scores of insurance policy holders throng AIA offices in around Asian countries to surrender their insurance policies. Singapore was not spared despite assurance and public notices put in major newspapers by AIA to assure their policy holders that the Singapore office has more than adequate capital to meet the demands of all their policy holders in the country.

In the week, Wall Street implodes with Merrill Lynch being acquired by Bank of America for US\$50 Billion in a deal stitched together in just 2 days. Meanwhile, Britain's Barclays Bank bought over Lehman's core investment banking operations for US\$250 Million, a fire sale price. Spreading across the shores, HBOS, Britain largest mortgage lender was rescued by Lloyds of Britain in a US\$22 Billion takeover. Meanwhile, European financial institutions were pushed to the brink with European shares plunging to a three and a half year low.

Too Little, Too Late; the US\$700 Billion Paulson Package

The global financial markets went through a roller-coaster ride as law makers at Capitol Hill debated the US\$ 700 Billion bail out plan. Many felt that the rescue plan did not address the root causes of the financial turmoil and were angered that the government is bailing out the non-prudent financial institutions at the expense of tax payers who are prudent savers. The presidential race between Senators John McCain and Barack Obama was reported as putting more spanners into the works that affected the finalization of the rescue plan.

In a white paper published on 24 Sep 08 by Weiss Research, an independent investment research company, it highlighted that the US\$700 Billion bail out plan is grossly inadequate. The paper argued that while the Federal Deposit Insurance Corporation (FDIC) listed a total of 117 troubled financial institutions with US\$78 Billion in assets; their research showed that this list did not include banks that have derivative risks, mortgage holdings of the largest regional banks and banks/thrifts that have TheStreet.com's Financial Strength Ratio of D+ or weaker. Including these banks/thrifts, the count of banks at risk of failure increased from the FDIC's 117 to 1,637 with a total asset size of US\$ 3.2 Trillion or 36 times over the assets of the troubled banks monitored by FDIC. A copy of this white paper can be found at <http://www.weissgroupinc.com/>

Systemic Solutions Needed

Six months ago, when the International Monetary Fund (IMF) estimated that more than US\$1 Trillion in financial sector losses and a sharp downturn in the global financial economy, they were criticized for being too pessimistic. Dominique Strauss-Kahn; Managing Director at the IMF proposed that a comprehensive approach to tackle the systemic issues by addressing the root causes. In the short-term, he recommended that 3 key elements are needed; liquidity provision; purchase of distressed assets and capital injections into troubled financial institutions. In the area of liquidity provision, Kahn noted that central banks must prevent runs on banks by reassuring depositors that bank deposits are safe and by providing liquidity to banks against good collateral. Secondly, distressed assets must be removed from the balance sheets of banks and an effective way to do this is to set up a government agency to buy these assets and hold them till they mature and can be safely resold – this is part of the Paulson's rescue plan. Finally, Kahn felt that the financial systems must be re-capitalised because he felt that the current financial system has too little capital and there is an immediate need to inject more capital into the system at the core of the current crisis.

However, Heizo Takenaka, a Keio University professor and former Japanese Minister of Economic and Fiscal Policy argued that providing injections of capital should be confined to banks and not to save insurance companies from bankruptcy. Injection of capitals into troubled banks is done not for the purpose of saving banks but to preserve the settlement infrastructure of the global financial markets.

There's really no magic solution to the current financial crisis but the good news is that most analysts felt that Asian countries will generally weather this storm as the general consensus is that as a whole, the Asian countries has little direct exposure to the US sub-prime loans or structured financial products. Moreover, the Asian's financial market is bank dominated and so far, the commercial banks have not been affected as much. However, it is inevitable that the financial crisis in the US and spreading through Europe will have a dampening effect on the economic growth in Asia countries.

The writer is the Principal Consultant & Director at Innovar Pte Ltd (www.innovar.com.sg).