THE COMPLEX DYNAMICS OF GLOBALIZATION AND THE FINANCIAL CRISIS

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This book is the second in a series published by BBVA Group as part of its effort to promote and spread knowledge. As such, it is in keeping with our group's vision statement, "BBVA, working for a better future for people."

Our work for people rests on two pillars: principles and innovation. Principles can be summed up as behaving in accordance with firm values of honesty, integrity, and transparency, and with the conviction that ethics are essential for establishing a lasting bond of trust with shareholders, clients, collaborators, regulating bodies, and society. Therefore, at BBVA, we believe that ethics are not only desirable, but also profitable. Moreover, a society in continual evolution, where change is a constant, not only in science and technology but also in values and lifestyles, obliges all organizations, especially those in close contact with their clients, to capture, develop, and apply the best knowledge in its quest for new solutions and processes, that is, to innovate.

Naturally, our fundamental contribution to the improvement of life for people has to come from our daily activity. That is why BBVA works on a daily basis to offer more and better solutions to our clients and to facilitate access to financial services for more people. By helping to make people's aspirations possible, we create more value in a sustainable way for our shareholders and a richer and more gratifying professional life for our collaborators. As such, we also contribute to the development and improvement of the wellbeing of all those societies in which we carry out our work.

But our commitment extends beyond the purely financial field, because we believe that economic and social development and stability in the societies where we are present are keys to BBVA Group's sustained growth. In order to achieve this, it is necessary to broaden the horizon of peoples' possibilities. In essence, that means broadening and deepening both individual and collective knowledge.

That is why BBVA is intensely active in social matters, fostering education and knowledge.

In the area of knowledge, BBVA Group works mainly through its Foundation to develop broad and recurrent programs in support of scientific research and the spread of scientific knowledge, with special emphasis on the social sciences, biomedicine, environmental, and basic sciences, as well as culture and the arts.

This line of work takes form in the two books from the series dedicated to knowledge that BBVA has published: books that broaden society's access to knowledge and debate on the leading questions shaping our time. For this project, we have sought out the finest researchers and creators worldwide so that, with the greatest rigor and objectivity, and in a language and approach accessible to non-specialists, they can explain and inform us of the advances in knowledge and the subject of the debates that are permanently active on the frontiers of science.

Our first book, *Frontiers of Knowledge,* was linked to the first edition of the awards of the same name awarded by the BBVA Foundation. It offered a broad view of the state of the art in the eight areas addressed by those prizes: the basic sciences, biomedicine, ecology and conservation biology, climate change, information and communications technologies, economics, finance and business administration, cooperation and development, and the contemporary arts.

In this second book we have chosen to present a panorama of globalization, a very complex and controversial phenomenon that is characteristic of present-day society and decisively influential in the daily lives of all the world's citizens at the beginning of the 21^{st} century.

GLOBALIZATION AND ITS EMERGENCE AS A MULTIDIMENSIONAL PHENOMENON

When the term "globalization" first entered use in the 1960s, its meaning was limited to the field of economics. Even today, Spain's Royal Academy defines it as "the tendency of markets and companies to expand, reaching a worldwide dimension that surpasses national frontiers" (DRAE 2006).

In the last two decades, the word "globalization" has passed from economic jargon to the status of universal cliché. *The Economist* has called it "the most abused word in the 21^{st} Century." It is used in all fields and applied to all sorts of phenomena. Thus, it is hardly strange to find it misused, unclear, or confusing.

All the same, its ubiquitous use and the interest it sparks lead us to conclude, first, that it reflects a very general perception that something fundamental is changing in the world; and second, that it is a complex, multidimensional, and characteristic phenomenon of our time.

To a large degree, globalization corresponds to a secular tendency. Understood as a deepening and an expansion of the scope of the exchange of goods, ideas, and people, this process is almost as old as humanity itself, dating back

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to the spread of homo sapiens across the globe some 50,000 years ago. In that sense, the discovery of America could also be considered a milestone in globalization, marking an acceleration of the process as well as the beginning of the transition to the modern age. A more immediate precedent would be the final decades of the nineteenth century and the beginning of the twentieth, a period of rapid expansion in global exchange that was only temporarily slowed by the First World War and the ensuing Great Depression.

It could be said that we are now witnessing a new and intense acceleration of globalization on our way to a new "global age" that transcends the concept of "nation," a concept that has ruled the history of humanity for the last five centuries.

Peter Worsley,[1] observed in the late 1980s that the map of a middle-class citizen's socioeconomic, political, and cultural reality in any developed country was built on the basis of nations. National borders served to define cultural systems, economic, social and political institutions, and even ways of life: "It is natural enough that most of us should be mainly concerned with the country in which we live. We also tend to think of the 'country'—the particular nation state—we live in as the maximal social unit not only of economic and political life, but also of social organization and culture, the 'way of life' we are part of" (Worsley 1987).

Stephen Toulmin emphasized the links between "modernity" and "nation state." And, following Peter Drucker in *Landmarks for Tomorrow,* he drew our attention to the breakdown of continuity between the structures of modernity and those from the last third of the twentieth century: "Drucker pointed out radical differences between current economic, social, and political conditions and those typically associated with the term 'Modernity'.... The times that we live in demand institutions of new and more functional kinds: institutions that overlap national boundaries and serve transnational social and economic needs" (Toulmin 1990).

During the first half of the last century, national institutions, structures and actors were at the center of activity; but after the Second World War the familiar landscape has filled with actors, organizations, structures, and problems that cannot be reduced to a national scale. This new situation has been driven by two decisive events: the decolonization movement in the 1960s and, two decades later, the collapse of the socialist bloc. In both cases, the number of sovereign nations increased but at the same time, a dynamic of greater integration grew out of strong demographic shifts, the creation of large shared economic spaces and political cooperation all over the planet.

Notwithstanding the importance that nation states and other smaller units still have, it is now recognized that there are major challenges and opportunities that can only be addressed in the context of the global system or, from another perspective, in the ecological-natural setting that Boulding labeled early on as "Spaceship Earth" (Boulding 1970). These expressions point up two connected questions: a) the emergence of political, socioeconomic, and environmental structures, organizations and problems that surpass national contexts and constitute the most finished expressions of globalization and the new ordering of social and economic reality; and b) the fact that even organizations and questions belonging, prima facie, to a local or national setting cannot operate or be fully understood outside the context of the natural "whole" to which they belong, that is, the global system of which they are a part.

To understand the process leading from these early notions to the current state of globalization we should at least briefly mention some of the factors that have promoted its unstoppable advance in the last two or three decades.

First, we must mention the variable of technology, especially information technology. The last decades of the twentieth century were characterized by sustained technological growth derived from the interaction between advances in telecommunications and computing, leading to the Internet and the World Wide Web. The advance of these "technologies without borders" brought the possibility of "communities without borders," as Ithiel de Sola Pool predicted even before wide-ranging use of the Web began (de Sola Pool 1990). Since then, an enormous amount of literature has appeared about the potential of these technologies. One of the main focuses of these analyses has been the virtual constitution of McLuhan's "Global Village." The reinforcement of the first communications infrastructure—transportation systems—with a second layer of information technology—mass media, the press, radio and television, but also the worldwide telephone network—has blurred the borders between social frameworks of various territorial dimensions.[2] At the same time, information technologies themselves, especially

1
Peter Worsley has been one of the pioneers at shifting the study of social problems to a global scale or space. Along with demographer, Alfred Sauvy, he was the first author of the conceptual scheme of the so-called "Third World."

2
As Marshall McLuhan wrote in *Understanding Media*: "...after more than a century of electronic technology, we have extended our central nervous system itself in a global embrace, abolishing both space and time as far as our planet is concerned."

the Internet, have been accelerating this process, bringing not only a few large organizations, but also smaller ones and individuals into "global society."

Secondly, we should mention the growing supranational and global *integration* of organizational modes of economic activity.[3] Many multinational corporations that still had strong cultural, organization, and directive roots in their home countries in the 1970s have metamorphosed into "global corporations" with capital, management, technology, and workers all over the planet, and with worldwide vertical and horizontal links. Their culture has also become global, spanning multiple local facets. At the same time, banking institutions have become global, with a very thick network of "real-time" connections between financial markets worldwide. This process has been parallel to the rapid supranational economic integration of much of Europe and, to a lesser degree, other regions of the world.

Thirdly, the process of political unity among the mosaic of Western European countries (traditionally separated by linguistic barriers, the diversity of their democratic political institutions, socioeconomic barriers, and even territorial conflicts and wars), along with the reunification of Germany and the collapse of the socialist countries, constitute one of the most radical transformations of the last century, with enormous impact on the 21st century's "new world order."[4]

Fourthly, since the final decades of the twentieth century, science, which has always transcended national borders, has experienced an unprecedented level of global integration. In this sense, current scientific society is both global and distributed, characterized by the active participation of research groups from a growing number of countries. As Professor Shankar points out in his contribution to the present book, information and Web technologies are making it possible for researchers from less-developed countries to take an active part in cutting-edge research. Moreover, many present-day scientific and technological research programs require a level of financial and technological resources that far surpass the possibilities of even the most developed countries. Supranational cooperation that includes designing shared projects and collaborating on the construction of large scientific installations has become the rule rather than the exception, especially in "cutting-edge" areas with the greatest techno-economic potential. What Derek de Solla Price called "big science" now involves global structures and resources (de Solla Price 1986). The adequate management of this "distributed" knowledge poses new and difficult problems on a global scale, which Brian Kahin addresses in his article in the present book.

Globalization has also been driven by growing awareness of planet-wide ecological problems that arose in the final decades of the twentieth century, including the hole in the ozone layer, global warming, the loss of biodiversity, and increasing difficult access to energy sources capable of sustaining the development of the most advanced countries as well as the rapidly emerging ones, like China.

Major ecological problems surpass analytical frameworks exclusively focused on national settings and, of course, any possible solution to them can hardly be viable without the adoption of *global perspectives* capable of preventing both *free rider* behavior by nations or national actors, and the imposition of excessive charges on insufficiently developed countries. These problems occupy the foreground of the agendas of leading governments and various organisms for international cooperation and government, adding significant impetus to new political forces and associations outside the profile of conventional political movements that aspire to promote decisions in a global setting (Keck and Sikkink 1998).

Finally, advanced information technologies, "compunications" (computing + telecommunications), along with the expansion of means of transportation and access to them, have significantly contributed to the *universalization* of culture and a broader consensus on a constellation of basic values that surpass national, ethnic, linguistic, or religious divisions. As Morgenthau pointed out over two decades ago, "When we say that this is 'One World,' we mean not only that the modern development of communications has virtually obliterated geographical distances with regard to physical contacts and exchange of information and ideas among the members of the human race. We mean also that this virtually unlimited opportunity for physical and intellectual communication has created that community of experience, embracing all humanity, from which a world public opinion can grow" (Morgenthau and Thompson 1985).

World studies of values carried out by Inglehart (one of the authors in the present book) over the last three decades document a significant process of convergence in the structure

3
All of these changes are the basis for an area of study halfway between economics, international relations, and sociology called *Gobal Political Economy* (Gill and Law 1988).

4
See Maier (1997) and Zelikow and Rice (1997).

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of individual values in large areas of the globe, overlapping divisions that organized and sometimes violent minorities seek to maintain on the basis of religious-moral credos (Inglehart *et al*. 2004).

But not all variables point to the constitution of a global community and polity. Morgenthau himself pointed out important limitations that we are still largely bound by: "Those who believe that world public opinion is the direct result of the free flow of news and ideas fail to distinguish between the technical process of transmission and the thing to be transmitted."

There are still societies or countries in which the principles of "traditional authority" continue to predominate over those of a "secular-rational" character (to use Inglehart's term), blocking the development of democracy, the market, and individual freedoms and rights. Another relevant obstacle to the construction of globalization's institutional structure on balanced foundations is the obsolescence of our ethical repertoire, which must be adapted to face the global problems of today, especially poverty and environmental management on a planetary scale, as has been pointed out by another of the authors of this book, Peter Singer (Singer 2009).

While a technological vector driving globalization and "remote presence" anywhere on the planet does exist, it is impossible to ignore the simultaneous presence of vectors in the opposite direction: national political controls and barriers and the cultural coordinates of a world that is still partially fragmented lead to different conclusions about what are, prima facie, the same items of information. These dissimilar experiences underlying how the "same" information is "read" or "interpreted" illustrate the difficulties involved in the development of global public opinion and the maintenance of the sort of radically opposing "worldviews" that eventually lead to the grave problem of global terrorism—a terrorism of unprecedented shape and scale that has emerged with the brutal attacks of September 11, 2001, March 11, 2004, and July 7, 2005 (in New York, Madrid, and London, respectively).

In sum, while much ground has already been covered and some of the dividing lines have faded, there are still too many major challenges to be resolved before the slogan "a single world" definitively displaces the duality to which Alfred Sauvy's trilogy has been reduced: the *first world* of highly developed and democratic countries, the *second world* of the socialist regimes (which have practically been extinguished), and the *third world* of underdeveloped nations.

In the final analysis, the fundamental barrier is the lack of correct understanding of our new reality, a failure on the part of public and private agents to the integrate facts and data on globalization into their mindscapes. Helping to correct these deficiencies should become a systematic objective of sciences—in particular, of social sciences.

In this sense, the modeling of what is global, which grew during the 1970s and 1980s, is receiving renewed attention with the advent of more powerful computers and conceptual and statistical algorithms and tools, as well as present-day economic models and sociological and political theories. While global models of climate change are now subject to mass media attention, there is less public awareness of the efforts of the pioneers of global modeling, to whom we must pay at least brief tribute.

The 1970s and 1980s saw a considerable development of "world" or "global" models based mainly on systems methodology. This generation of models had three characteristics that continue to be necessary today: a globalizing or all-encompassing character, a projection into the future (medium and even long-term), and a practical-technological vocation (furnishing instruments for changing policies and constellations of values in the present in order to prevent the occurrence of regional or global catastrophes).

Among these first-generation models, we should mention the Rome Club studies, *World Dynamics* and *The Limits to Growth.* The second report to the Rome Club, M. Mesarovic and E. Pestel's *Mankind at the Turning Point* (1974), contributed to the spreading of a "global" sensibility in public opinion, transcending systems with national coordinates but also establishing "regional" distinctions. In other words, correcting the excessively uniform view of the planet presented in the first report. The trends estimate undertaken by Mesarovic and Pestel's *World Integrated Model* (WIM) was based on two postulates: firstly, that human societies are subsystems of a worldwide "totality," notwithstanding its conservation of identity in "regional" frameworks or aggregates; and secondly, that the world had reached "the current condition in which nations and regions around the globe are not only mutually influential, but also strongly depend on each other. The new global problems characteristic of our current era, such as worldwide dependence on shared amounts of raw materials, energy and food supply problems, the shared use of the physical environment on land, sea and the atmosphere, etc., as well as traditional political, ideological, and economic ties, have contributed to this transition. The world community seems to be a 'system,' by which we mean a group of interdependent parts rather than a group of practically independent entities as in the past." Consequently, many of the "locally" or "regionally" generated problems can be felt all over the planet. And yet that does not imply the existence of a single, homogenous, and monolithic world, as the facts clearly show.

The methodological caution of early modeling efforts must be maintained today, in a context where an excessive emphasis on the standardizing tendencies of globalization can hide the existence of both "local" processes and structures with high "degrees of freedom," and their mutual interaction.

New knowledge offered by the environmental and social sciences, along with the formidable power of current statistical and computational instruments, should foster a greater understanding of global dynamics, offering robust frameworks that can be carried over to the sensibilities of the citizenry and the worldviews of public decision makers. Specifically, one of our Foundation's initial guidelines will be support for multidisciplinary research and dialog on the questions of global society.

GLOBALIZATION AND CRISIS: TOWARDS A NEW DYNAMIC OF GLOBALIZATION?

As we have seen, globalization is not, strictly speaking, a new phenomenon, although in our time it has reached a previously unknown magnitude. Nor are financial crises anything new; they are as old as money itself. And ever since financial systems reached a certain level of development they have invariably manifested characteristics that Minsky (1972) described as "abrupt drops in the price of assets (financial and/or real), bankruptcies of companies (financial and/or non financial ones), deflation (or rapid disinflation), and strong perturbations in foreign exchange markets." Those elements can combine in different forms and proportions.

Financial crises are actually quite common. In his now classic *Manias, Panics & Crashes* (1978), Charles Kindleberger lists over 30 significant crises in Western Europe and the United States in the two centuries between 1729 and the Great Depression. One of the first analyses of the Asian crisis (IMF 1998) pointed out that between 1975 and 1997 there had been some 240 financial crises in different countries around the world.

Despite the considerable frequency of such crises (around 20 a year) at a time when globalization is rapidly advancing, there is no evidence (Bordo *et al*. 2001) that globalization "causes" crises. There is, however, abundant evidence that it favors their expansion or contagion and multiplies their impact. But that is inevitable since, as historian Niall Ferguson concluded: "Globalization is about connectivity and integration" (Ferguson 2003).

If today's high degree of globalization is a key to explaining the virulence and breadth of the current crisis, then it makes sense to ask what effect this crisis will have on the globalization process.

That is the question addressed by Raimo Väyrynen and Jordi Canals in their contributions and it also underlies other articles in the present book. Nevertheless, in this introduction I would like to offer a few observations based on my experience at the helm of a transnational bank, that is, as an active agent for globalization in an industry at the heart of the crisis and deeply affected by it.

Many analysts hypothesize that the crisis will signify a strong step backward for globalization, as occurred with the Great Depression in the 1930s.

Of course there is already proof that the crisis has had a strongly negative initial impact: international financial flows have dwindled and, for the first time in many years, the volume of international trade shrank in absolute terms in 2008 and will continue to do so in 2009.

There is also a noticeable increase in protectionism: various countries are applying different tariffs and authorities in many places have called for the consumption of "national" products.

The difficulties experienced by some large multinational companies due to the crisis have triggered other political reactions to favor national interests over foreign ones: support for banks on the condition that credit increases within the country, help with industrial restructuring in order to shift factory closings and/or cutbacks in the workforce to other countries, etc.

Definitively, national political influence has gained much greater weight among transnational companies, and that phenomenon is most significant in the banking sector. Today, governments participate in the capital of banks that represent over 75% (in the US) or 40% (in Europe) of the capitalization of the sector before the crisis. This state power is reinforced by other public aid mechanisms that do not involve public ownership but nevertheless constitute very powerful instruments of control.

Moreover, many geopolitical analysts are worried by growing global instability stemming from the worsening of general economic conditions and the weaknesses of the United States and other developed Western countries, which have been brought out by the crisis.

Even before the crisis, despite extraordinarily favorable economic conditions, globalization was the object of strong criticism in certain sectors of opinion and the crisis has given new force to its adversaries.

Still, there are also reasons to think that this wave of globalization is different than earlier ones: there are differences in the absolute and relative volumes of international loans, trade, and investment flows, as well as in the magnitude and degree of integration of financial markets, the number and proportion of people living and working in foreign countries, and so on.

Even more relevant are the qualitative differences, which I can sum up in two fundamental aspects:

Firstly, the existence of organizations and mechanisms for international coordination that, no matter how imperfect or insufficient, help govern international financial and economic activity. In fact, unlike what happened during the Great Depression, in the present crisis different countries have reacted decisively and their fundamental actions have been coherent on a global level.

Secondly, and certainly more importantly: this is the globalization process that has spread throughout the world with the greatest speed, breadth, and depth.

Globalization has had a transforming effect on the economy, culture, and society with unprecedented intensity and speed. Global prosperity over the last twenty years, with high, sustained growth almost worldwide, has a common denominator: the participation of a larger number of countries in the global economy and their integration in international trade and financial flows.

Globalization has contributed to improving the living conditions and opportunities for prosperity of many world citizens, bettering health, education, and, in the broad sense, the spread of information and knowledge, as has even been recognized by fierce critics of globalization, such as Joseph Stiglitz: "Globalization has given many people in the developing world access to knowledge well beyond the reach of even the wealthiest in any country a century ago" (Stiglitz 2003).

Over the two decades before the crisis, the percentage of people living in extreme poverty (less than one US dollar a day) in developing countries has been cut in half. And those areas where poverty has not dropped (especially sub-Saharan Africa) are precisely those where globalization has been least present. In that respect, see, for example, Dollar and Kraay (2002 and 2004).

Even more differentiation can be seen in the fact that globalization has become "individualized" thanks to the telecommunications revolution and computing. The Internet has become a "personal" tool to integrate the life of each individual into a universe of information, contacts, and possibilities for developing all sorts of activities. This is no longer a mere economic change, it affects culture and many ways of life, making the present process of globalization far more rapid, complex, and uncontrollable than any previous one.

Nowadays, globalization is such a multiform process, with such a broad base and such depth that no political force in the world is able to "shield" its society from external influences.

Now, this process that offers so many opportunities is not without its risks. One is undoubtedly a greater risk of contagion and another is the greater speed with which crises can spread, thus broadening their impact with the ensuing aftereffects such as recession, increased poverty, and inequality.

And cultural and social changes occurring over very different bases and at different speeds in different parts of the world also increase the possibility of conflict.

In this context, globalization fosters the spread of problems on a scale that no country or organization can address single handedly: climate change and the deterioration of the environment, nuclear proliferation, illegal immigration, organized crime, terrorism, and pandemics.

Therefore, the most adequate reaction to the crisis is not to combat globalization nor to passively accept its unwanted consequences, but rather to try to develop policies that make it possible to strengthen its advantages and prevent or limit its negative impact.

First and foremost, we need to manage our emergence from the crisis in the best possible way for everyone. And we must build the foundations for an economic and financial order less vulnerable to imbalances—one that will allow sustained and high levels of growth while articulating solutions to major global problems.

As we emerge from the crisis, it is essential that international organizations—especially the G-20, but also the multilateral institutions (IMF, WTO, etc.) avoid acts that would hinder commercial integration. Economic stimulus programs and national aid to companies or sectors must be sufficiently coordinated to avoid "beggar-thy-neighbor" exchange programs that encourage competitive devaluations and exacerbate currency instability. No less important is the coordination of "exit strategies" (returning interest rates to more "normal" levels in the middle and long terms and a gradual correction of the enormous fiscal deficits that are being generated).

As to the major global questions mentioned above, this book offers a broad and authoritative spectrum: Loayza focuses on the fight against poverty; Broecker, Lovejoy, and Laurance address climate change and environmental deterioration, while Tomlinson, Gumbrecht, Inglehart, and Singer bring different viewpoints to the complexity of our time's cultural, religious, and ethical values.

Facing all these questions demands, in turn, better and more participative mechanisms for designing and applying solutions, that is, a renewal and strengthening of schemes for global government. In this volume Scholte offers an ambitious proposal.

The configuration of the G-20 as the main forum for discussing global subjects has been an important step. But this is only a first step in a long, difficult path towards a new global order that will have to function on the basis of a very complex multilateralism, balancing "global" interests with national ones, and with those of many other geographic or delocalized networks being generated by "virtual" civil society. One of the fundamental characteristics of globalization, as Dicken points out in his essay for this book, is that, far from "flattening" or simplifying the world, globalization creates multiple relevant geographies, some of which are supranational, others subnational—though highly globalized—such as global cities, to which Saskia Sassen dedicates an essay in this volume. In this context, it is only possible to move forward on the basis of recognizing interdependence, respect for all parties, and work for the common good.

Changing attitudes, values and strategies at a geopolitical level will only be sustainable and will only lead to positive results if they coincide with equally profound changes in the attitudes, values, and strategies of the leading private agents of globalization, that is, large transnational companies, including banks.

GLOBALIZATION, CRISIS, AND CHANGE IN THE FINANCIAL INDUSTRY

A very important chapter of the immediate global agenda concerns the financial industry in general and the banking sector in particular.

This is so because the financial sector is a fundamental motor for development, making outstanding contributions to growth and improvements in global wellbeing in recent decades. And also, unfortunately, because the financial sector has played a fundamental role in the genesis and development of the crisis.

Many financial institutions have certainly committed grave errors in their analysis and control of risk, leading to what has clearly been excessive leveraging; greed and the desire for large short-term profits have taken the fore, often fostered by incorrectly designed incentives.

But all of this was possible because, at the same time, there were serious errors in the regulation and supervision of financial entities.

And, of course, very important errors of judgment in macroeconomic policies: it should have been obvious that a long period with extraordinarily low interest rates, rapid growth of liquidity, and the accumulation of balance of payment imbalances would lead, at some point, to very grave problems.

None of this is new: it would be hard to find a crisis in which there were no imprudent financial intermediaries, insufficient or inefficient regulation and supervision, or errors of microeconomic management.

But this crisis had a key differential factor: the very high degree of internationalization (globalization) of the financial industry, which led, among other things, to an elevated exposure of many banks around the world to a set of assets that turned out to be highly "toxic."

The fall of those assets' prices on the market triggered a vicious circle that constitutes what we could call the first phase of the crisis: losses led to decisions to sell those assets but the lack of liquidity made this impossible. That, in turn, even farther depressed the prices of toxic and also some non-toxic assets, further increasing losses and lack of liquidity. The final outcome was the global "credit crunch" that is the main factor triggering this recession, the worst in the last seventy years.

The danger of a generalized banking crisis with devastating effects for the global economy was the first concern for authorities all over the world. Their reaction has been rapid and unprecedented it its forcefulness: we have seen drastic cuts in official interest rates, massive injections of liquidity, a generalized extension of deposit guarantees, and substantial public reinforcement of the capital of many entities, some of which had to be rescued in extremis.

All of this prevented the collapse of the international finance system, marking the end of the first part of the crisis.

We now find ourselves in the second "economic" phase, in which the predominant negative effect is the recession's impact on banks in the form of a drop in activity and, most of all, a deterioration of the quality of their credit portfolios, with a sustained increase in defaulted loans.

We are now looking at a greatly weakened global financial system that is facing a very unfavorable economic situation. Right now, cyclical indicators show the beginning of a recovery, but this recovery is of very uncertain size and duration, given the global economy's accumulated imbalances—especially high public deficits and an enormous volume of public debt, mainly on the part of developed nations.

This is the setting in which the global financial industry will have to deal with the third, essentially "banking," phase of the crisis: a radical transformation to adapt to the profound industrial and technological changes that have taken place in recent decades.

Technological advances have affected all industries, but their most disruptive effects are in those whose "products" are susceptible to digital storage, processing, and transmission.

We have, for example, seen important changes in the automobile industry over the last two decades, but its products and its production and distribution processes remain essentially unchanged. Let us compare this to what has occurred in the music industry, where the last five years have seen a revolutionary shift from DVDs sold in stores to Spotify, which allows access at any moment to an almost infinite variety of recordings for less than what an hour of music used to cost.

Of course the banking industry's product is much closer to that of the music industry: its raw materials are money and information, both of which can be reduced to bits (in the case of money, this is called "book entries") transmitted instantaneously at almost no cost.

And yet, if we look at banking's distribution processes—especially those of retail banking—we find them much closer to those of automobiles than to those of music. Banks still depend on networks of physical offices distributing products and services whose uniformity makes them practically identical for all clients. Of course there are remote channels, but they are used mostly for carrying out everyday transactions and, to a much lesser degree, for selling "commoditized" products and services.

In banking today, there is potential for incalculable gains in efficiency (and thus in price), in convenience for customers, and in the possibility of personalizing products to meet specific needs.

Until now, this transformation has not taken place for a variety of reasons, including specific regulation of banking and the sector's own burgeoning profits in recent years. Now, however, it will be inevitable: firstly, because at any moment a financial business model could appear on the web with absolutely disruptive effects for the banking sector and, secondly, because the financial crisis itself has changed, and will continue to change, the status quo.

Moreover, a predictably lower growth rate to that of the past decade (even when the global economy recovers) and a tendency towards more rigorous regulation—especially requirements affecting capital and backup, consumer protection, etc.—will tend to reduce growth and profitability in the financial industry. This context makes a radical improvement of the industry's efficiency levels even more necessary.

Part of that improvement may come from consolidation of the sector, as there is, in fact, a significant excess of installed capacity in the global banking system. This has been clearly brought out by the crisis, whose effects have already begun to correct it.

But this will only lead to limited improvements in efficiency. It therefore becomes essential to move the industry towards a much more technology-based model that will radically lower production and distribution costs.

This will be a difficult transformation but its success will be of fundamental import because the construction of a more robust, efficient, and "inclusive" global financial system is essential not only for recovery after the crisis but also for a sustained improvement in wellbeing for people all over the world.

What can authorities do to favor this result?

Clearly, over the next few years we will be advancing in the direction of greater regulation and control of financial activity. I believe this is justified, given the problems generated by the extremely permissive atmosphere of recent years and its ensuing cost to taxpayers of many of the world's countries, and to global growth and wellbeing.

But it is most important that there be better regulation rather than just more of it. In my opinion, there are three fundamental needs:

Firstly, that the requirements imposed by regulation and supervision be sufficiently uniform and coordinated on an international level.

Secondly, that government decisions, as well as those by regulators and supervisors, promote, or at least do not hinder, the consolidation of the industry, as this is a necessary condition—though not sufficient by itself—for attaining a more efficient and stable global financial system.

Thirdly, we must make sure that incentives are aligned with value created in the middle and long terms.

Public policies and regulations will be an important element in determining the future of the banking industry, but the decisive factor will be the behavior of civil society (which includes finance companies themselves).

LOOKING AHEAD: VALUES AND INNOVATION IN BANKING FOR PEOPLE

Until now, all large transnational companies, including banks, have prospered in a world characterized by three basic elements: technological advance; the growing power of increasingly well-informed consumers; and increasingly global markets that nevertheless coexist with by very different regulations, cultures, and social structures (what Ghemawat calls "semiglobalization").

The success of those companies has rested on their capacity to efficiently manage those three elements to create more value.

The crisis has raised new elements of uncertainty about how the globalization process will evolve, and thus about how company strategies should be adjusted.

In this book, Pankaj Ghemawat's article focuses on this question. And if I can add anything it will be on the basis of my direct experience in the banking field, a sector with significant peculiarities that nevertheless represents an industry in the process of accelerated globalization whose competitive and operating conditions have been especially altered by the crisis.

Banking activity is based on client trust. This is also the major competitive advantage of banks over possible newcomers to this business, mainly those companies capable of constructing alternative models free from the "legacies" of banks, which makes them much more agile and efficient.

Client trust is reflected in the information about themselves that they allow banks access to. Using increasingly sophisticated technology, banks can turn this information into knowledge that, in turn, can be used to offer clients solutions to a widening range of needs—solutions that are better, that is, more opportune, convenient, and adapted to their personal conditions.

This means that trust is at the base of banking today and it provides the leverage for its transformation.

But the same clients that have historically placed their trust in banks have grown increasingly demanding because they are aware that banks have more information and more capacity to exercise the power that comes with such information. Technology offers enormous possibilities for coordinating the actions of people who can now exercise much more powerful activism. In that sense, maintaining our users' trust increasingly requires not only quality products and services, but also a good reputation in ethical terms.

All companies must be managed within an increasingly demanding framework of ethical principles and values. But this demand is especially important for banks. The inexcusable behavior of many banks and bankers during the recent crisis, and the enormous cost this behavior has generated for the general citizenry have eroded the reputation of the entire sector.

Banks and bankers need to take a hard look at themselves. Concepts such as ethical values, transparency, prudence, awareness of social problems, and sustainability must become an integral part of the culture, strategies, and daily management of banks. They must also be a key vector in internal and external communication.

This will require revising certain basic aspects of the paradigm of banking activity, beginning with the very concept of "value created for shareholders" as the final objective and

CONCEPTS SUCH AS ETHICAL VALUES, TRANSPARENCY, PRUDENCE, AWARENESS OF SOCIAL PROBLEMS, AND SUSTAINABILITY MUST BECOME AN INTEGRAL PART OF THE CULTURE, STRATEGIES, AND DAILY MANAGEMENT OF BANKS. THEY MUST ALSO BE A KEY VECTOR IN INTERNAL AND EXTERNAL COMMUNICATION.

yardstick for management. The views of other stakeholders must be included, as must a greater consideration of the long-term interests of shareholders.

Corporate government, incentive and bonus schemes, as well as the contents and forms of interaction with society also need a profound revision.

Along with these values and their application to banking activity and communications, innovation should also be a key element in the new banking paradigm. None of the above will make any sense if banks are incapable of drastically improving the service they offer to their clients and to society as a whole. Banks must understand and use technology intelligently to generate useful solutions that satisfy peoples' needs.

The transformation of banking during the third phase of the crisis mentioned above will be what allows banks to help their markets expand. Only with superior technological capacity and a degree of efficiency that far surpasses present levels will banks be able to offer new products and services to their clients, as well as furnishing services to those—over 80% of the world's population—for whom current models of conventional banking are unaffordable.

This great leap forward will also require values and innovation, an absolute focus on people.

Banks need technology, but they also need the talent of people who can configure a new organizational and cultural model centered on the people that are its clients. They need people capable of understanding the cultural differences, habits, and interests of others all over the world. The transformation of banking will only be achieved through a search for the talent, diversity, and flexibility needed to understand differences and adapt to them.

Some of these paradigm shifts are already under way; others have yet to be precisely formulated. The most important thing is to understand that the banking industry is not facing a mere financial or technical adjustment; it is at a philosophical crossroads.

All of these changes represent a formidable threat to existing banks, but also a great opportunity for those that emerge from the crisis with sufficient financial solidity and, most of all, capacity and will to adapt and innovate.

At BBVA we are determined to be a part of the latter category. For the last five years we have been following a strategy based on three pillars (principles, people, and innovation). We are working to construct a bank with values, one capable of creating value in a sustained manner, generating and offering useful, real innovations to people.

This strategy is what sets our behavior apart from most of the sector in the midst of the crisis; and it is what underlies our effort to take the lead in transforming the banking business into a much more efficient model that brings far more value to people and to society as a whole.

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