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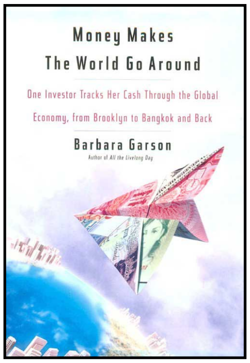

Money Makes The World Go Around

One Investor Tracks Her Cash Through The Global Economy, From Brooklyn to Bangkok and Back

by Barbara Garson

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342 pages

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Take-Aways

- We now live in a global economic system where capital flows worldwide.
- By U.S. law, a corporate checking account cannot earn interest. This provision has encouraged the growth of offshore banking transactions.
- By law, banks cannot loan more than 15% of their capital to any one borrower.
- These limitations foster syndicated loans, where banks join together to make a loan.
- Banks have discovered that getting money to invest is easy, but finding qualified people to lend to is difficult.
- Banks and companies are “awash” in cash.
- The pressure to find sources to lend money also drives investment overseas.
- Side effects of the pressure to earn ever-increasing returns include mergers, restructuring and massive layoffs.
- When speculators decide a currency is overvalued and start to sell, almost no government is strong enough to prop the currency up.
- Eventually, due to economic disruptions in people’s lives, the pendulum may swing back to capital-market regulation.

Rating (10 is best)

Overall	Applicability	Innovation	Style
8	**6**	**8**	**7**

Relevance

What You Will Learn

In this Abstract, you will learn: 1) What happens to money that you deposit in your hometown bank; and 2) How money flows globally.

Recommendation

Some books set out to accomplish the impossible and come admirably close. Barbara Garson's volume is a prime example. Can you deposit money in a little rural bank and really trace its spread across the global monetary system? How do you know that a multi-million dollar loan to, say, shrimp exporters in Thailand, really has anything to do with the actual dollars you deposited? But that's not the point of this book. The author embarks on a whirlwind, worldwide tour of the global financial juggernaut, and shows how money falls like a drop in a pond and emits waves of disruption that seemingly spread out forever. Garson concludes that deregulation needs to be reigned in, a reasonable anticipation of the Enron mess. *getAbstract.com* highly recommends her book to business people and consumers who want a better feel for what the "global economic order" is all about, why people are protesting at each meeting of the WTO and whether you should be steamed as well.

Abstract

New World Disorder?

Is the New World Economic Order such a great idea? That may be a question the World Trade Organization ponders every day. Utopian visions of a worldwide monetary system date back to Woodrow Wilson and The League of Nations. However, today's global village was created according to the ethos of Rupert Murdoch, rather than Eleanor Roosevelt. Considering the current economic difficulties, this is an apt time to consider the effect of the worldwide free flow of capital without regard to national borders or barriers.

"When I made the deposit that started this story, I thought of my money as the raw material that banks need and want in order to make more money. But I was beginning to sense, however fuzzily, that it could also be a hot potato that Millbrook (bank) passed to Chase and Chase had to pass quickly to the next guy."

What happens when you deposit money in, say, the Bank of Millbrook in rural horse country, about an hour and a half up the Hudson from New York City? Where does the money travel? Whose efforts and initiatives will it support? Will it be invested evenly, fairly and efficiently? Can anyone really track where the money goes?

To begin to answer that question, first note that by law, no U.S. bank can lend more than 15% of its capital to one borrower. Large corporations, however, require large loans. When this demand occurs, a lead institution such as Citibank or Chase, associates with other banks in a "syndicated loan." All banks have a "correspondent" relationship with at least one major bank for services such as check clearing and foreign exchange. Banks also have less formal arrangements, or friendships, where they take part of a loan and send another part to a colleague-bank. That way, no one institution has too much exposure. Theoretically, that means savings invested in a sleepy little bank could finance oil development in Venezuela.

"Whoever held it, even for a second, had to pay interest. Which means he had to be able to collect interest. If he couldn't, he got burned."

Another important concept is the multiplier effect of deposits. By special arrangement with the U.S. government, banks may lend about 10 times the amount they take in as deposits. A bank can leverage a $25,000 deposit to create $250,000 worth of loans that people can use to open pizza parlors or bookstores or to renovate a home — assuming the bank approves the loan. Disapproving bad loans is an important bank responsibility.

Banks stay in business by making good loans. Millbrook was a family-owned bank that had made prudent investments and loans for more than a century. Unlike big banks that undergo restructuring and mergers when someone makes a mistake, at a small bank someone must know when to say "no." Bank regulators actually look for one or two bad loans to make sure a bank isn't being too conservative — but the fact that a bank has been around for a long time suggests that somebody has been using good judgment.

"The bankers I met on the upper floors at Chase Manhattan Plaza didn't want to make loans and collect interest, they wanted to underwrite offerings and collect fees. The real money, I learned, was in helping corporate clients float bonds or issue stocks."

Yet, the Bank of Millbrook has a problem. Like most small-town banks, it can't find enough local interest-paying markets for its investments. A substantial deposit in Millbrook is almost certain to end up elsewhere. That's where correspondent banking comes in. By law, every bank must keep about three percent of its deposits in the Federal Reserve Bank, which pays no interest on the money. While the fund adds stability to the national banking system, each bank tries to keep its Federal funds to a minimum, since they earn nothing. Banks do not want extra funds in their Federal Reserve accounts, but woe to any bank that drops below its reserve requirement, a violation with severe penalties. That's such a dire happenstance that most bankers don't even know what the penalties are — it's too punitive to contemplate.

The Money Starts to Move

When a bank like Millbrook ends up with more cash than it can use locally, it can always loan it to Citibank or Chase Manhattan. These banks have very predictable needs for extra money to keep on the right side of their Fed-funds account. So the small banks sell money to their correspondent banks, which starts the whole money flow rolling internationally. Millbrook sold Fed fund money — about $3 million — to Chase Manhattan daily. So on the day you make a deposit to Millbrook, some of your money will likely flow to its correspondent bank.

"The striking word in many of these interviews was 'awash.' Banks were awash in deposits; large corporations were so awash in profits that they could be their own banks."

From there, it might flow overseas. Leonard Walker, a Chase loan official, essentially sells money. His Middle Market team sold loans to companies with revenues from $10-$500 million annually. He might lend to a Russian cosmetics manufacturer or an importer of frozen Asian seafood. But a loan of less than half a million is beneath his interest. Just his fee for a loan might be $500,000 — after all, his shareholders expect a 15 to 20% return.

For example, in Thailand, a company called Caltex was building a brand new oil refinery — the first time in 25 years that a green field refinery had been built from scratch by a major oil company. Chase helped to finance big Thai and Singapore project loans, and Caltex had a Chase line of credit. So money deposited in Millbrook helped finance an 81-meter, 450-ton crude oil processing tower in a country where the typical settlement for a worker killed in an industrial accident is about 300,000 baht, or $10,000 U.S. dollars.

"A couple of deregulated decades had concentrated huge globs of money under the control of companies and individuals who seemed to be having increasing trouble finding anything to do with it besides buying and selling each other."

Mangrove Action Project

The Mangrove Action Project, back in the United States, is devoted to preserving the coastal mangrove forests where many fish spawn. It disapproves of loans to Asian shrimp operations, because shrimp farming has ripped out about a quarter of the world's mangroves. The Mangrove Action Project was working with NGOs (Non-Governmental Organizations) from regions where sea turtles and humans are both endangered by the destruction of key ecological niches. Money deposited in Millbrook didn't just go to big international corporations. Some of it trickled down to the more than 70% of the Thai population living in rural areas. Many of them worked for big seafood companies that borrowed money through Mr. Walker at Chase Manhattan.

"A bust is the predictable end of any boom; in fact, it's the hindsight definition: if it busted, it was a boom."

When a group of countries sent representatives to a United Nations Shrimp Tribunal, the mangrove crowd showed up to oppose World Bank shrimp-farm loans. Such loans, some argued, destabilized self-sufficient communities because banks could never collect interest from subsistence fishermen who, by definition, stop when they have enough to eat. While they did not oppose all World Bank loans, these advocates sought a safe way to harvest seafood in a sustainable manner. Money deposited in sleepy little Millbrook, it turned out, could have important political consequences.

Restructuring

Companies sometimes merge under economic pressure to improve their competitive positions, thereby generating greater returns for their shareholders. Such disruptions could have substantial effects, as did the merger between Chase Manhattan and Chemical Banks. In essence, Chemical bought out Chase, although they kept the Chase name. One stockholder, Michael Price, watched his 11 million shares of Chase Manhattan increase in value by some 70% over the course of less than six months, an increase worth $275 million dollars. The merger had other effects. For instance, about 12,000 jobs would be eliminated. It turns out that anything with a structure can be restructured — including your job.

"The entire continent of Africa seems to be used up right now. The banks concentrate almost exclusively on collecting on old loans."

Chase stockholder Price also played a key role in dismantling the Sunbeam Oster company. He helped take the company public, then asked along with others that its board unlock shareholder value. One way the CEO and board sought to improve Sunbeam's profitability was to bring in turnaround maven "Chainsaw Al" Dunlap, author of *Mean Business: How I Save Bad Companies and Make Good Companies Great*. Dunlap's four secrets:

- Get the right management team.
- Pinch pennies and cut costs.
- Know what business you're in and focus the business like a laser. Find your firm's "hidden" corporate bank — the money you will raise selling assets.
- Visualize the company's future, and plan a strategic route to get there.

"If and when Third Worlders can't pay, the bankers and investors will bring their losses back home. As for the round that's just starting, it doesn't seem likely that the banks will be bailed in this time. So the options in the next overlending crisis are once again peasants pay and/or Western taxpayers pay.

From an investor's perspective, it didn't matter whether Dunlap made a company more effective by cutting away the fat to make for a beautiful new focused business; or by putting in quick fixes that would hold long enough to sell the company at a good price. In other words, the fate of the money mattered, but the fate of the company didn't. Dunlap's turnaround plan for Sunbeam began with cutting half its employees. Employees at all 50 of Sunbeam's appliance manufacturing facilities had to wait to find out which plants Dunlap was closing. As time went on and Sunbeam failed to recover, even Dunlap was fired.

Bye Bye Baht

Money flowing into a company or a country also can flow back out. This happened during the Asian economic crisis. One morning thousands of currency traders logged onto their computers to sell Thai bahts. Some knew that the spate of expensive overbuilding in Bangkok had left some bad loans on the books. Others were concerned that the Thai economy was as shaky as a rickshaw. Still others accurately estimated that the currency was simply overvalued, making it a choice target for a "currency attack."

"Wherever my money went, it changed the landscape and it changed lives."

When the attack came, the Thai government struggled briefly to hold at about 24 baht to the dollar. They used their store of foreign currencies to buy the baht. Huge hedge funds

"The money is so skittish, and the pressure that propels it from one highest return to the next is so great, that it usually can't be stopped until after the rubber band breaks."

and others dropped bahts like they were radioactive, and the government couldn't keep up. When the Thai government ran out of funds to buy its currency, the value of the baht fell nearly in half. Next, the stock market began to drop as investors rushed to get out of anything connected with Thailand. Soon, the flight of capital spread up and down the southeast Asian peninsula. Almost overnight, the Asian Tiger economies were locked in a cage.

The effects were devastating. Countless citizens lost their jobs and more than 100,000 vehicles were repossessed six months after the crash. As Citibank CEO Walter Wriston once said, however, "Countries don't go broke." Unlike banks, no matter how ill advised their loans, countries rarely disappear. Eventually, Thailand and southeast Asia would recover.

Southeast Asia's travails are merely symptoms of the effects of the globalization of money. Today, the waves of unregulated capital are bigger. They finance expansion — a boom — which, when it overreaches itself, results in contraction — a bust. Human lives get caught in the middle. If three oil refineries succeed in an area, someone will build a fourth and a fifth. The only way to know it has gone too far is when profits suffer. To an economist, this is merely a correction. But for the person who gets laid off, the real-world effects of these disruptive waves are devastating. In part, this is because overbuilding exacts a toll from the environment, damage that continues long after overcapacity has faded. Yes, the Asian market eventually re-emerged. That doesn't change the fact that the swings are simply too extreme. Today, regulating capital is out of fashion. As more people are affected by the boom or bust cycle, however, the idea of humanizing economies will again come to the fore.

"That's what creates the constant change I find so exhilarating, but that's also what creates so much insecurity for so many people in the world."

Epilogue

A nest-egg of $29,500 invested in the Bank of Millbrook earned just under 2.5% interest over five years. The $5,000 invested in mutual funds increased to $7,791. Had the Millbrook money been invested that way, it would have been worth about $44,000 three years later. The results would have been even better without a disastrous venture at Sunbeam. Viewed from the perspective of a mutual fund investor, the instability caused by worldwide flows of capital don't seem nearly so disturbing — at least not when you're making the profit.

About The Author

Barbara Garson has written for *The New York Times*, *Harpers*, *The Washington Post*, *The Los Angeles Times*, *The Boston Globe* and *Newsweek*. Her nonfiction writing has earned a Guggenheim Fellowship, a National Endowment for the Arts Fellowship and a National Press Club Citation. She wrote a best-selling book, *MacBird!*, two well-known volumes about the workplace, *All the Livelong Day* and *The Electronic Sweatshops*, and several plays, including *Security* and the Obie Award-winning children's play, *The Dinosaur Door.*

Buzz-Words

Correspondent banks / **C**urrency attack / **R**eserve accounts / **S**yndicated loans

