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# Global Financial Crisis 2008

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by Anup Shah | This Page Last Updated Sunday, December 07, 2008

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The global financial crisis, brewing for a while, really started to show its effects in the middle of 2007 and into 2008. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems.

On the one hand many people are concerned that those responsible for the financial problems are the ones being bailed out, while on the other hand, a global financial meltdown will affect the livelihoods of almost everyone in an increasingly inter-connected world. The problem could have been avoided, if ideologues supporting the current economics models weren't so vocal, influential and inconsiderate of others' viewpoints and concerns.

This article provides an overview of the crisis with links for further, more detailed, coverage at the end.

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## **A crisis so severe, the world financial system is affected**

Following a period of economic boom, a financial bubble—global in scope—has now burst.

A collapse of the US sub-prime mortgage market and the reversal of the housing boom in other industrialized economies have had a ripple effect around the world. Furthermore, other weaknesses in the global financial system have surfaced. Some financial products and instruments have become so complex and twisted, that as things start to unravel, trust in the whole system started to fail.



John Bird, John Fortune, Subprime Crisis<sup>1</sup>, February 14, 2008

While there are many technical explanations of how the sub-prime mortgage crisis came about, the mainstream British comedians, John Bird and John Fortune, describe the mindset of the investment banking community in this satirical interview, explaining it in a way that sometimes only comedians can.

Together with impressionist Rory Bremner, derivatives (securities derived from other securities) are also explained:



Bremner, Bird, and Fortune, Silly  
 Money: Where did all the money go?<sup>2</sup>,  
 Part 3, November 10, 2008



Bremner, Bird, and Fortune, Silly  
 Money: Where did all the money go?<sup>3</sup>,  
 Part 4, November 10, 2008

The betting of practically anything helped create enormous sums of money out of almost nothing. However, as former US Presidential speech writer, Mark Lange<sup>4</sup>, notes, “because [derivatives are] entirely unregulated and trade on no public exchanges, their originators can deliberately hide their vulnerabilities.”

The extent of the problems has been so severe that some of the world’s largest financial institutions have collapsed. Others have been bought out by their competition at low prices and in other cases, the governments of the wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial institutions.

Towards the end of October, the Bank of England said the world’s financial firms had now lost £1.8 trillion (\$2.8 trillion) as a result of the continuing credit crisis<sup>5</sup>. Global taxpayers have now spent around \$8 trillion to shore up the world’s banks. These amounts will increase as the crisis spreads into the real economy.

The effect of this, the United Nation’s Conference on Trade and Development says in its Trade and Development Report 2008<sup>6</sup> is, as summarized by the *Third World Network*, that

the global economy is teetering on the brink of recession. The downturn after four years of relatively fast growth is due to a number of factors: the global fallout from the financial crisis in the United States, the bursting of the housing bubbles in the US and in other large economies, soaring

commodity prices, increasingly restrictive monetary policies in a number of countries, and stock market volatility.

... the fallout from the collapse of the US mortgage market and the reversal of the housing boom in various important countries has turned out to be more profound and persistent than expected in 2007 and beginning of 2008. As more and more evidence is gathered and as the lag effects are showing up, we are seeing more and more countries around the world being affected by this rather profound and persistent negative effects from the reversal of housing booms in various countries.

— Kanaga Raja, *Economic Outlook Gloomy, Risks to South, say UNCTAD*<sup>7</sup>, *Third World Network*, September 4, 2008

## **A crisis so severe, those responsible are bailed out**

Some of the bail-outs have also been accompanied with charges of hypocrisy due to the appearance of “socializing the costs while privatizing the profits.” The bail-outs appear to help the financial institutions that got into trouble (many of whom pushed for the kind of lax policies that allowed this to happen in the first place).

Some governments have moved to make it harder to manipulate the markets by shorting<sup>8</sup> during the financial crisis blaming them for worsening an already bad situation.

(It should be noted that during the debilitating Asian financial crisis in the late 1990s, Asian nations affected by short-selling complained, without success<sup>9</sup> that currency speculators—operating through hedge funds or through the currency operations of commercial banks and other financial institutions—were attacking their currencies through short selling and in doing so, bringing the rates of the local currencies far below their real economic levels. However, when they complained to the Western governments and International Monetary Fund (IMF), they dismissed the claims of the Asian governments, blaming it on their own economic mismanagement instead.)

Other governments have moved to try and reassure investors and savers that their money is safe. In a number of European countries, for example, governments have tried to increase or fully guarantee depositors’ savings. In other cases, banks have been nationalized (socializing profits as well as costs, potentially.)

In the meanwhile, smaller businesses and poorer people rarely have such options for bail out and rescue when they find themselves in crisis.

There seems to be little sympathy—and even growing resentment—for workers in the financial sector, as they are seen as having gambled with other people’s money, and hence lives, while getting fat bonuses and pay rises for it in the past. Although in raw dollar terms the huge pay rises and bonuses are small compared to the magnitude of the problem, the encouragement such practices have given in the past, as well as the type of culture it creates, is what has angered so many people.

### **Side note on those taking on risky loans in the subprime market**

In the case of subprime mortgages, it is also argued that those who took on the risky loans are to blame;

they should not have borrowed so much money when they knew they would not have the means to repay. While there is truth to this, and our culture of expecting easy money, consuming beyond our means, etc is something that needs urgent attention, in the case of subprime mortgages, it seems easy to forget the predicament of people living in relative poverty. Financial advisors that irresponsibly pushed these loans (with no interest or care of the borrower in mind) were generally aggressive as they had a lot to gain from these loans.

For people living in poverty even in wealthy countries<sup>10</sup> life can be desperate and miserable. Concerns will range from crime in the neighborhood, to good schooling, to getting by week by week on very little, and ensuring a job lasts. The hope of being able to escape it for a while was, in effect, exploited. When in poverty, long term thinking is not always going to enter the realm of immediate concern.

Furthermore, it is likely that those lower down the social strata are not going to be as financially savvy as those further up. Hence there is usually more trust placed in a bank or financial advisor. It is often forgotten these days that banks and financial institutions have changed in nature; there is less concern about the people they serve, but more about how they can sell products from which they can make profit.

To some extent risky borrowers bear some responsibility, but overall they have lost out; lenders are being bailed out, while those taking out risky loans either have lost their homes, or face a real threat of losing their home in the near future.

## **A crisis so severe, the rest suffer too**

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There is the argument that when the larger banks show signs of crisis, it is not just the wealthy that will suffer, but potentially everyone. With an increasingly inter-connected world, things like a credit crunch can ripple through the entire economy.

For example, banks with little confidence to lend may lend with higher interest rates. People may find their mortgages harder to pay, or remortgaging could become expensive. For any recent home buyers, the value of their homes are likely to fall in value leaving them in negative equity. In the wider economy, many sectors may find the credit crunch and higher costs of borrowing will lead to job cuts. As people will cut back on consumption to try and weather this economic storm, yet other businesses will struggle to survive leading to further fears of job losses.

The real economy in many countries is already feeling the effects. Many industrialized nations are sliding into recession if they are not already there.

## **The financial crisis and wealthy countries**

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Many blame the greed of Wall Street for causing the problem in the first place because it is in the US that the most influential banks, institutions and ideologues that pushed for the policies that caused the problems are found.

The crisis became so severe that after the failure and buyouts of major institutions, the Bush Administration offered a \$700 billion bailout plan for the US financial system.



Joseph Stiglitz, Nobel Laureate Joseph Stiglitz: Bail Out Wall Street Now, Change Terms Later<sup>11</sup>, Democracy Now!, October 2, 2008

This bailout package was controversial because it was unpopular with the public, seen as a bailout for the culprits while the ordinary person would be left to pay for their folly. The US House of Representatives initially rejected the package as a result, sending shock waves around the world.

It took a second attempt to pass the plan, but with add-ons to the bill to get the additional congressmen and women to accept the plan.

However, as former Nobel prize winner for Economics, former Chief Economist of the World Bank and university professor at Columbia University, Joseph Stiglitz<sup>12</sup>, argued, the plan “remains a very bad bill:”

I think it remains a very bad bill. It is a disappointment, but not a surprise, that the administration came up with a bill that is again based on trickle-down economics. You throw enough money at Wall Street, and some of it will trickle down to the rest of the economy. It's like a patient suffering from giving a massive blood transfusion while there's internal bleeding; it doesn't do anything about the basic source of the hemorrhaging, the foreclosure problem. But that having been said, it is better than doing nothing, and hopefully after the election, we can repair the very many mistakes in it.

— Joseph Stiglitz, Nobel Laureate Joseph Stiglitz: Bail Out Wall Street Now, Change Terms Later<sup>13</sup>, Democracy Now!, October 2, 2008

Writing in *The Guardian*, Stiglitz also added that,

Americans have lost faith not only in the [Bush] administration, but in its economic philosophy: a new corporate welfarism masquerading behind free-market ideology; another version of trickle-down economics, where the hundreds of billions to Wall Street that caused the problem were supposed to somehow trickle down to help ordinary Americans. Trickle-down hasn't been working well in America over the past eight years.

The very assumption that the rescue plan has to help is suspect. After all, the IMF and US treasury bail-outs for Wall Street 10 years ago in Korea, Thailand, Indonesia, Brazil, Russia and Argentina

didn't work for those countries, although it did enable Wall Street to get back most of its money. The taxpayers in these other poor countries picked up the tab for the financial markets' mistakes. This time, it is American taxpayers who are being asked to pick up the tab. And that's the difference. For all the rhetoric about democracy and good governance, the citizens in those countries didn't really get a chance to vote on the bail-outs.

...

In environmental economics, there is a basic concept called the polluter pays principle. It is a matter of fairness, but also of efficiency. Wall Street has polluted our economy with toxic mortgages. It should now pay for the cleanup.

— *Joseph Stiglitz, Good day for democracy; Now Congress must draw up a proposal in which costs are borne by those who created the problem*<sup>14</sup>, *The Guardian*, October 1, 2008

In Europe, starting with Britain, a number of nations decided to nationalize, or part-nationalize, some failing banks to try and restore confidence. The US resisted this approach at first, as it goes against the rigid free market view the US has taken for a few decades now.

Eventually, the US capitulated and the Bush Administration announced that the US government would buy shares in troubled banks<sup>15</sup>.

This illustrates how serious this problem is for such an ardent follower of free market ideology to do this (although free market theories were not originally intended to be applied to finance, which could be part of a deeper root cause of the problem).

Perhaps fearing an ideological backlash, Bush was quick to say that buying stakes in banks “is not intended to take over the free market, but to preserve it.” Professor Ha-Joon Chang of Cambridge University suggests that historically America has been more pragmatic about free markets than their recent ideological rhetoric suggests<sup>16</sup>, a charge by many in developing countries that rich countries are often quite protectionist themselves but demand free markets from others at all times.

While the US move was eventually welcomed by many, others echo Stiglitz's concern above. For example, former Assistant Secretary of the Treasury Department in the Reagan administration and a former associate editor of the *Wall Street Journal*, Paul Craig Roberts also argues that the bailout should have been to help people with failing mortgages, not banks<sup>17</sup>: “The problem, according to the government, is the defaulting mortgages, so the money should be directed at refinancing the mortgages and paying off the foreclosed ones. And that would restore the value of the mortgage-backed securities that are threatening the financial institutions [and] the crisis would be over. So there's no connection between the government's explanation of the crisis and its solution to the crisis.”

(Interestingly, and perhaps the sign of the times, while Europe and US consider more socialist-like policies, such as some form of nationalization, China seems to be contemplating more capitalist ideas<sup>18</sup>, such as some notion of land reform, to stimulate and develop its internal market. This, China hopes, could be one way to try and help insulate the country from some of the impacts of the global financial crisis.)

Despite the large \$700 billion US plan, banks have still been reluctant to lend. This led to the US Fed announcing

another \$800 billion stimulus package<sup>19</sup> at the end of November. About \$600bn is marked to buy up mortgage-backed securities while \$200bn will be aimed at unfreezing the consumer credit market. This also reflects how the crisis has spread from the financial markets to the “real economy” and consumer spending.

## **A crisis signaling the decline of US’s superpower status?**

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Even before this global financial crisis took hold, some commentators were writing that the US was in decline, evidenced by its challenges in Iraq and Afghanistan, and its declining image in Europe, Asia and elsewhere.

The *BBC* also asked if the US’s superpower status was shaken by this financial crisis:

The financial crisis is likely to diminish the status of the United States as the world’s only superpower. On the practical level, the US is already stretched militarily, in Afghanistan and Iraq, and is now stretched financially. On the philosophical level, it will be harder for it to argue in favor of its free market ideas, if its own markets have collapsed.

... Some see this as a pivotal moment.

The political philosopher John Gray, who recently retired as a professor at the London School of Economics, wrote in the London paper *The Observer*: “Here is a historic geopolitical shift, in which the balance of power in the world is being altered irrevocably.

“The era of American global leadership, reaching back to the Second World War, is over... The American free-market creed has self-destructed while countries that retained overall control of markets have been vindicated.”

... “How symbolic that Chinese astronauts take a spacewalk while the US Treasury Secretary is on his knees.”

— *Paul Reynolds, US superpower status is shaken*<sup>20</sup>, *BBC*, October 1, 2008

Yet, others argue that it may be too early to write of the US:

The director of a leading British think-tank Chatham House, Dr Robin Niblett ... argues that we should wait a bit before coming to a judgment and that structurally the United States is still strong.

“America is still immensely attractive to skilled immigrants and is still capable of producing a Microsoft or a Google,” he went on. “Even its debt can be overcome. It has enormous resilience economically at a local and entrepreneurial level.

“And one must ask, decline relative to who? China is in a desperate race for growth to feed its population and avert unrest in 15 to 20 years. Russia is not exactly a paper tiger but it is stretching its own limits with a new strategy built on a flimsy base. India has huge internal contradictions. Europe has usually proved unable to jump out of the doldrums as dynamically as the US.

“But the US must regain its financial footing and the extent to which it does so will also determine its military capacity. If it has less money, it will have fewer forces.”

— Paul Reynolds, *US superpower status is shaken*<sup>21</sup>, BBC, October 1, 2008

## Europe and the financial crisis

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In Europe, a number of major financial institutions failed. Others needed rescuing.

A number of European countries have attempted different measures<sup>22</sup> (as they seemed to have failed to come up with a united response).

For example, some nations have stepped in to nationalize or in some way attempt to provide assurance for people. This may include guaranteeing 100% of people's savings or helping broker deals between large banks to ensure there isn't a failure.

The EU is also considering spending increases and tax cuts said to be worth €200bn<sup>23</sup> over two years. The plan is supposed to help restore consumer and business confidence, shore up employment, getting the banks lending again, and promoting green technologies.

## The financial crisis and the developing world

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For the developing world, the rise in food prices<sup>24</sup> as well as the knock-on effects from the financial instability and uncertainty in industrialized nations are having a compounding effect. High fuel costs, soaring commodity prices together with fears of global recession are worrying many developing country analysts.

Summarizing a United Nations Conference on Trade and Development report, the *Third World Network* notes the impacts the crisis could have around the world, especially on developing countries that are dependent on commodities for import or export:

Uncertainty and instability in international financial, currency and commodity markets, coupled with doubts about the direction of monetary policy in some major developed countries, are contributing to a gloomy outlook for the world economy and could present considerable risks for the developing world, the UN Conference on Trade and Development (UNCTAD) said Thursday.

... Commodity-dependent economies are exposed to considerable external shocks stemming from price booms and busts in international commodity markets.

Market liberalization and privatization in the commodity sector have not resulted in greater stability of international commodity prices. There is widespread dissatisfaction with the outcomes of unregulated financial and commodity markets, which fail to transmit reliable price signals for commodity producers. In recent years, the global economic policy environment seems to have become more favorable to fresh thinking about the need for multilateral actions against the negative impacts of large commodity price fluctuations on development and macroeconomic stability in the world economy.

— Kanaga Raja, *Economic Outlook Gloomy, Risks to South, say UNCTAD*<sup>25</sup>, *Third World Network*, September 4, 2008

## Asia and the financial crisis

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Countries in Asia are increasingly worried about what is happening in the West. A number of nations urged the US to provide meaningful assurances and bailout packages for the US economy, as that would have a knock-on effect of reassuring foreign investors and helping ease concerns in other parts of the world.

Many believed Asia was sufficiently decoupled from the Western financial systems. Asia has not had a subprime mortgage crisis like many nations in the West have, for example. Many Asian nations have witnessed rapid growth and wealth creation in recent years. This led to enormous investment in Western countries. In addition, there was increased foreign investment in Asia, mostly from the West.

However, this crisis has shown that in an increasingly inter-connected world means there are always knock-on effects and as a result, Asia has had more exposure to problems stemming from the West. Many Asian countries have seen their stock markets suffer and currency values going on a downward trend. Asian products and services are also global, and a slowdown in wealthy countries means increased chances of a slowdown in Asia and the risk of job losses and associated problems such as social unrest.

Towards the end of October 2008, a major meeting between the EU and a number of Asian nations resulted in a joint statement pledging a coordinated response to the global financial crisis. However, as *Inter Press Service* (IPS) reported, this coordinated response is dependent on the entry of Asia's emerging economies into global policy-setting institutions<sup>26</sup>.

This is very significant because Asian and other developing countries have often been treated as second-class citizens when it comes to international trade, finance and investment talks<sup>27</sup>. This time, however, Asian countries are potentially trying to flex their muscle, maybe because they see an opportunity in this crisis, which at the moment mostly affects the rich West.

Asian leaders had called for “effective and comprehensive reform of the international monetary and financial systems.” For example, as *IPS* also noted in the same report, one of the Chinese state-controlled media outlets demanded that “We want the U.S. to give up its veto power at the International Monetary Fund and European countries to give up some more of their voting rights in order to make room for emerging and developing countries.” They also added, “And we want America to lower its protectionist barriers allowing an easier access to its markets for Chinese and other developing countries' goods.”

Whether this will happen is hard to know. Similar calls by other developing countries and civil society around the world, for years, have come to no avail. This time however, the financial crisis could mean the US is less influential than before. A side-story of the emerging Chinese superpower versus the declining US superpower will be interesting to watch.

It would of course be too early to see China somehow using this opportunity to decimate the US, economically, as it has its own internal issues. While the Western mainstream media has often hyped up a “threat” posed by a growing China, the World Bank's chief economist (Lin Yifu, a well respected Chinese academic) notes “Relatively speaking, China is a country with scarce capital funds and it is hardly the time for us to export these funds and pour them into a country profuse with capital like the U.S.”

Asian nations are mulling over the creation of an alternative Asia foreign exchange fund, but market shocks are making some Asian countries nervous and it is not clear if all will be able to commit.

What seems to be emerging is that Asian nations may have an opportunity to demand more fairness in the international arena, which would be good for other developing regions, too.

## **Africa and the financial crisis**

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Perhaps ironically, Africa's generally weak integration with the rest of the global economy may mean that many African countries will not be affected from the crisis, at least not initially<sup>28</sup>, as suggested by *Reuters*.

The wealthier ones who do have some exposure to the rest of the world, however, may face some problems.

In the long run, it can be expected that foreign investment in Africa will reduce as the credit squeeze takes hold. Furthermore, foreign aid<sup>29</sup>, which is important for a number of African countries, is likely to diminish. (*Effectiveness* of aid is a separate issue which the previous link details.)

In recent years, there has been more interest in Africa from Asian countries such as China. As the financial crisis is hitting the Western nations the hardest, Africa may yet enjoy increased trade for a while.

African countries could face increasing pressure for debt repayment, however<sup>30</sup>. As the crisis gets deeper and the international institutions and western banks that have lent money to Africa need to shore up their reserves more, one way could be to demand debt repayment. This could cause further cuts in social services such as health and education, which have already been reduced due to crises and policies from previous eras<sup>31</sup>.

Much of the debts owed by African nations are odious, or unjust debts, as detailed further below, which would make any more aggressive demands of repayment all the more worrisome.

## **Latin America and the financial crisis**

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Much of Latin America depends on trade with the United States (which absorbs half of Latin America's exports, alone, for example). As such Latin America will also feel the effect of the US financial crisis and slower growth in Latin America is expected<sup>32</sup>.

Due to its proximity to the US and its close relationship via the NAFTA and other agreements, Mexico is expected to have one of the lowest growth rates for the region next year<sup>33</sup> at 1.9%, compared to a downgraded forecast of 3% for the rest of the region.

A number of countries in the region have come together in the form of the Latin American Pacific Arc and are hoping to improve trade and investment with Asia. Diversifying in this way might be good for the region and help provide some stability against future crises. For the moment, the integration is going ahead<sup>34</sup>, despite concerns about the financial crisis.

## **A crisis in context**

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While much mainstream media attention is on the details of the financial crisis, and some of its causes, it also

needs to be put into context (though not diminishing its severity).

## **A crisis of poverty for much of humanity**

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Almost daily, some half of humanity or more, suffer a daily financial, social and emotional, crisis of poverty<sup>35</sup>. In poorer countries, poverty is not always the fault of the individual alone, but a combination of personal, regional, national, and—importantly—international influences. There is little in the way of bail out for these people, many of whom are not to blame for their own predicament, unlike with the financial crisis.

There are some grand strategies to try and address global poverty, such as the UN Millennium Development Goals, but these are not only lofty ideals and under threat from the effects of the financial crisis (which would reduce funds available for the goals), but they only aim to halve poverty and other problems. While this of course is better than nothing it signifies that many leading nations have not had the political will to go further and aim for more ambitious targets, but are willing to find far more to save their own banks, for example.

## **A global food crisis affecting the poorest the most**

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While the media's attention is on the global financial crisis (which predominantly affects the wealthy and middle classes), the effects of the global food crisis<sup>36</sup> (which predominantly affects the poorer and working classes) seems to have fallen off the radar. The two are in fact inter-related issues, both have their causes rooted in the fundamental problems associated with a neoliberal, one-size-fits-all, economic agenda<sup>37</sup> imposed on virtually the entire world.

## **Poor nations will get less financing for development**

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The poorer countries do get foreign aid<sup>38</sup> from richer nations, but it cannot be expected that current levels of aid (low as they actually are) can be maintained as donor nations themselves go through financial crisis. As such the Millennium Development Goals to address many concerns such as halving poverty and hunger around the world, will be affected.

Almost an aside, the issue of tax havens<sup>39</sup> is important for many poor countries. Tax havens result in capital moving out of poor countries into havens. An important source of revenue, domestic tax revenues account for just 13% of low income countries' earnings, whereas it is 36% for the rich countries<sup>40</sup>, as *Inter Press Service* notes.

A UN-sponsored conference slated for November 2008 to address this issue is unlikely to get much attention or be successful due to the recession fears and the financial crisis. But this capital flight is estimated to cost poor countries from \$350 billion to \$500 billion in lost revenue, outweighing foreign aid by almost a factor of 5.

This lost tax revenue is significant for poor countries. It could reduce, or eliminate the need for foreign aid (which many in rich countries do not like giving, anyway), could help poor countries pay off (legitimate) debts, and also help themselves become more independent from the influence of wealthy creditor nations.

Politically, it may be this latter point that prevents many rich countries doing more to help the poor, when monetarily it would be so easy to do so.

## **Odious third world debt has remained for decades; Banks and military get money easily**

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Crippling third world debt<sup>41</sup> has been hampering development of the developing countries for decades. These debts are small in comparison to the bailout the US alone was prepared to give its banks, but enormous for the poor countries that bear those burdens, having affected many millions of lives for many, many years.

Many of these debts were incurred not just by irresponsible government borrowers (such as corrupt third world dictators, many of whom had come to power with Western backing and support<sup>42</sup>), but irresponsible lending (also a moral hazard) from Western banks and institutions they heavily influenced, such as the IMF and World Bank.

Despite enormous protest and public pressure for odious debt relief or write-off, hardly any has occurred, and when it does grand promises of debt relief for poor countries often turn out to be exaggerated<sup>43</sup>. One recently described “historic breakthrough” debt relief was announced as a \$40 billion debt write-off<sup>44</sup> but turned out to be closer to \$17 billion in real terms. To achieve even this amount required much campaigning and pressuring of the mainstream media to cover these issues.

By contrast, the \$700 billion bail out as well as bailouts by rich other country governments were very quick to put in place. The money then seemed easy to find. Talk of increasing health or education budgets in rich countries typically meets resistance. Massive military spending<sup>45</sup>, or now, financial sector bail out, however, can be done extremely quickly.

And, a common view in many countries seems to be how financial sector leaders “get away” with it. For example, a hungry person stealing bread is likely to get thrown into jail. A financial sector leader, or an ideologue pushing for policies that are going to lead to corruption or weaknesses like this, face almost no such consequence for their action other than resigning from their jobs and perhaps public humiliation for a while.

## **A crisis that need not have happened**

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This problem could have been averted (in theory) as people had been pointing to these issues for decades. Yet, of course, during periods of boom no-one (let alone the financial institutions and their supporting ideologues and politicians largely believed to be responsible for the bulk of the problems) would want to hear of caution and even thoughts of the kind of regulation that many are now advocating. To suggest anything would be anti-capitalism or socialism or some other label that could effectively shut up even the most prominent of economists raising concerns.

Of course, the irony that those same institutions would now themselves agree that those “anti-capitalist” regulations are required is of course barely noted. Such options now being considered are not anti-capitalist. However, they could be described as more regulatory or managed rather than completely free or laissez faire capitalism, which critics of regulation have often preferred. But a regulatory capitalist economy is very different to a state-based command economy, the style of which the Soviet Union was known for. The point is that there are various forms of capitalism, not just the black-and-white capitalism and communism. And at the same time, the most extreme forms of capitalism can also lead to the bigger bubbles and the bigger busts.

Quoting Stiglitz again, he captures the sentiments of a number of people:

We had become accustomed to the hypocrisy. The banks reject any suggestion they should face regulation, rebuff any move towards anti-trust measures — yet when trouble strikes, all of a sudden they demand state intervention: they must be bailed out; they are too big, too important to be allowed to fail.

...

America's financial system failed in its two crucial responsibilities: managing risk and allocating capital. The industry as a whole has not been doing what it should be doing ... and it must now face change in its regulatory structures. Regrettably, many of the worst elements of the US financial system ... were exported to the rest of the world.

— *Joseph Stiglitz, The fruit of hypocrisy; Dishonesty in the finance sector dragged us here, and Washington looks ill-equipped to guide us out*<sup>46</sup>, *The Guardian*, September 16, 2008

Some of these regulatory measures have been easy to get around for various reasons. Some reasons for weak regulation<sup>47</sup> that entrepreneur Mark Shuttleworth describes include that regulators

- Are poorly paid or are not the best talent
- Often lack true independence (or are corrupted by industries lobbying for favors)
- May lack teeth or courage in face of hostile industries and a politically hostile climate to regulation.

Given its crucial role, it is extremely important to invest in it too, Shuttleworth stresses.

However, this crisis wasted almost a generation of talent:

It was all done in the name of innovation, and any regulatory initiative was fought away with claims that it would suppress that innovation. They were innovating, all right, but not in ways that made the economy stronger. Some of America's best and brightest were devoting their talents to getting around standards and regulations designed to ensure the efficiency of the economy and the safety of the banking system. Unfortunately, they were far too successful, and we are all — homeowners, workers, investors, taxpayers — paying the price.

— *Joseph Stiglitz, The fruit of hypocrisy; Dishonesty in the finance sector dragged us here, and Washington looks ill-equipped to guide us out*<sup>48</sup>, *The Guardian*, September 16, 2008

The wasted capital, labor and resources all add up<sup>49</sup>.

British economist John Maynard Keynes, is considered one of the most influential economists of the 20th century and one of the fathers of modern macroeconomics. He advocated an interventionist form of government policy believing markets left to their own measure (i.e. completely “freed”) could be destructive leading to cycles of recessions, depressions and booms. To mitigate against the worst effects of these cycles, he supported the idea that governments could use various fiscal and monetary measures. His ideas helped rebuild after World War II, until the 1970s when his ideas were abandoned for freer market systems.

Keynes' biographer, professor Robert Skidelsky, argues that free markets have undermined democracy and led to this crisis in the first place:

What creates a crisis of the kind that now engulfs us is not economics but politics. The triumph of the global “free” market, which has dominated the world over the last three decades has been a political triumph.

It has reflected the dominance of those who believe that governments (for which read the views and interests of ordinary people) should be kept away from the levers of power, and that the tiny minority who control and benefit most from the economic process are the only people competent to direct it.

This band of greedy oligarchs have used their economic power to persuade themselves and most others that we will all be better off if they are in no way restrained—and if they cannot persuade, they have used that same economic power to override any opposition. The economic arguments in favor of free markets are no more than a fig leaf for this self-serving doctrine of self-aggrandizement.

— *Bryan Gould, Who voted for the markets? The economic crisis makes it plain: we surrendered power to wealthy elites and fatally undermined democracy*<sup>50</sup>, *The Guardian*, November 26, 2008

Furthermore, he argues that the democratic process has been abused and manipulated to allow a concentration of power that is actually against the idea of free markets and real capitalism:

The uncomfortable truth is that democracy and free markets are incompatible. The whole point of democratic government is that it uses the legitimacy of the democratic mandate to diffuse power throughout society rather than allow it to accumulate—as any player of Monopoly understands—in just a few hands. It deliberately uses the political power of the majority to offset what would otherwise be the overwhelming economic power of the dominant market players.

If governments accept, as they have done, that the “free” market cannot be challenged, they abandon, in effect, their whole *raison d'etre*. Democracy is then merely a sham. ... No amount of cosmetic tinkering at the margins will conceal the fact that power has passed to that handful of people who control the global economy.

— *Bryan Gould, Who voted for the markets? The economic crisis makes it plain: we surrendered power to wealthy elites and fatally undermined democracy*<sup>51</sup>, *The Guardian*, November 26, 2008

Despite Keynesian economics getting a bad press from free market advocates for many years, many are now turning to his policies and ideas to help weather the economic crisis.

We are all Keynesians<sup>52</sup> now. Even the right in the United States has joined the Keynesian camp with unbridled enthusiasm and on a scale that at one time would have been truly unimaginable.

... after having been left in the wilderness, almost shunned, for more than three decades ... what is happening now is a triumph of reason and evidence over ideology and interests.

Economic theory has long explained why unfettered markets were not self-correcting, why regulation was needed, why there was an important role for government to play in the economy. But many, especially people working in the financial markets, pushed a type of “market fundamentalism<sup>53</sup>.” The misguided policies that resulted — pushed by, among others, some members of President-elect Barack Obama’s economic team — had earlier inflicted enormous costs on developing countries. The moment of enlightenment came only when those policies also began inflicting costs on the US and other advanced industrial countries.

...

The neo-liberal push for deregulation served some interests well. Financial markets did well through capital market liberalization. Enabling America to sell its risky financial products and engage in speculation all over the world may have served its firms well, even if they imposed large costs on others.

Today, the risk is that the new Keynesian doctrines will be used and abused to serve some of the same interests.

— Joseph Stiglitz, *Getting bang for your buck*<sup>54</sup>, *The Guardian*, December 5, 2008

## Dealing with recession

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Most economic regions are now facing recession, or are in it. This includes the US, the Eurozone, and many others.

At such times governments attempt to stimulate the economy. Standard macroeconomic policy includes policies to increase borrowing, reduce interest rates, reduce taxes and spend on public works such as infrastructure.

Borrowing at a time of recession seems risky, but the idea is that this should be complimented with paying back during times of growth.

Likewise, reducing interest rates sounds like there would be less incentive for people to save money, when banks need to build up their capital reserves. However, as the real economy starts to feel the pinch, reduced interest rates is an attempt to encourage people to take part in the economy.

Tax reduction is something that most people favor, and yet during times of economic downturn it would seem that a reduction in tax would result in reduced government revenues just when they need it and then spending on health, education, etc, would be at risk. However, because higher taxes during downturns means more hardship for more people, increased borrowing is supposed to offset the reduction in taxes, hopefully affording people a better chance to weather the economic storm.

Finally it is at this time that public infrastructure work, which can potentially employ many, many people, is palatable. Often, under free market ideals, government involvement in such activities is supposed to be minimal. Even the other forms of “interference” is usually frowned upon. However, most states realize that markets are not always able to function on their own (the current financial crisis, starting in the US, being the prime example); pragmatic and sensible adoption of market systems means governments can guide development and progress as required.

Nonetheless, many governments have started to contemplate these kinds of measures. For example, South Korea reduced its interest rates<sup>55</sup>, as has Japan<sup>56</sup>, China<sup>57</sup>, England<sup>58</sup>, various European countries, and many others.

Many have looked to borrow billions or in some way come up with stimulus packages to try and kick-start ailing economies.

While these might be reasonably standard things to do, it requires that during economic good times, a reversal of some of these policies are required; interest rates may need to increase (one reason for the housing booms in the US, UK and elsewhere was that interest rates were too low during good times), borrowing should be reduced and debts should start to be repaid, infrastructure investments may not need to be as direct from government and private enterprise may be able to contribute, and most politically sensitive of all, taxes should increase again to offset the reduction in borrowing.

Each of these steps should no doubt come under scrutiny from opposition parties and the media, to ensure they are appropriate, but some, such as tax hikes during good times can be so politically sensitive, that governments may be afraid to make such choices, thus making economic policies during bad times even riskier as a result.

Even then, the severity of these economic problems means that these strategies are not guaranteed to work, or it may take even longer to take effect. For example, as quarterly figures for various companies start to come out, more and more companies are announcing losses, closures, layoffs or other problems; people are becoming very nervous about the economy and spending less.

The automobile industry in the US, for example, is feeling immense pressure with some of the largest companies in the world facing huge problems and are asking the government for some kind of bailout or assistance. Yet, the US public generally seems against this, having already bailed out the banks with enormous sums of money. If the automobile industry is bailed out, then other industries will all cry for more money; when would it stop?

In addition, as Joseph Stiglitz warns, some nations are turning to the IMF which is prescribing the opposite policies:

Many are already turning to the International Monetary Fund (IMF) for help. The worry is that, at least in some cases, the IMF will go back to its old failed recipes: fiscal and monetary contraction, which would only increase global inequities. While developed countries engage in stabilizing countercyclical policies, developing countries would be forced into destabilizing policies, driving away capital when they need it most.

— *Joseph Stiglitz, Let's throw away the rule book; Bretton Woods II must establish economic doctrines that work in emerging economies as well as in capitalism's heartland*<sup>59</sup>, *The Guardian*, November 6, 2008

In Iceland, where the economy was very dependent on the finance sector, economic problems have hit them hard. The banking system virtually collapsed and the government had to borrow from the IMF and other neighbors to try and rescue the economy. However, Iceland has raised its interest rates to some 18%, partly on advice from the IMF<sup>60</sup>. It would appear to be an example where high interest rates may be inappropriate. The economic problems have led to political challenges including protests and clashes<sup>61</sup>.

It may be that this time round a more fundamental set of measures need to be considered, possibly global in

scope. The very core of the global financial system is something many are now turning their attention to.

## Rethinking the international financial system?

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Many people are now calling for fundamental reforms of the financial systems, internationally. This includes international banking and finance, to reform of international financial institutions such as the World Bank and IMF.

Part of the reform suggestions also include giving more voice and power to poor countries, who typically have little say in how the global economy is shaped.

Traditionally powerful countries have resisted these calls—that have been voiced for decades, not just during this crisis. This crisis however has seen even powerful countries contemplate changes that would be more favorable to emerging nations. Whether these changes can happen is hard to predict.

## Reforming international banking and finance?

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Leaders of the Bank of England have also called for fundamental international banking reform<sup>62</sup>. Bank of England deputy governor Sir John Gieve said the “fundamental rethink” meant increasing capital and liquidity requirements at institutions with “strong restraints on the build up of risk.”

Some of the ideas considered are quite significant, such as increasing the reserves banks must have. (Fractional reserve banking often allows banks to have small reserves against which loans can then be made out for larger amounts as usually most people do not withdraw their cash deposits at the same time. This works well in good times, but can then lead to a crisis through encouraging more loans which get riskier as competition increases; a moral hazard in reverse.)

The Bank of England’s governor, Mervyn King, even went as far as saying a “little more boredom” would not be a bad thing for the industry. This too is significant as it suggests restraint for an industry that otherwise is a strong proponent of financial market liberalization and supportive of very rapid growth. The recognition here appears to be that maybe slower but more stable long term growth is better and sustainable in the long run rather than short bursts of high growth followed by disruptive bursts, some of which can be very violent as the current crisis is showing.

Joseph Stiglitz argues that failures in financial markets have come about because of poorly designed incentive structures, inadequate competition, and inadequate transparency. Part of this is because larger institutions have been resistant to changes that would actually create more healthy competition, something Adam Smith had long noted in his *Wealth of Nations*, often regarded as the Bible of capitalism. Better regulation is required to reign in the financial markets and bring back trust in the system. In a short but very powerful article he concludes,

Part of the problem has been our regulatory structures. If government appoints as regulators those who do not believe in regulation, one is not likely to get strong enforcement. We have to design robust regulatory systems, where gaps in enforcement are transparent. Relatively simple regulatory systems may be easier to implement and more robust, and more resistant to regulatory capture.

Well-designed regulations may protect us in the short run and encourage real innovation in the long. Much of our financial market's creativity was directed to circumventing regulations and taxes. Accounting was so creative that no one, not even the banks, knew their financial position. Meanwhile, the financial system [has] resisted many of the innovations that would have increased the efficiency of our economy. By reducing the scope for these socially unproductive innovations, we can divert creative activity in more productive directions.

The agenda for regulatory reform is large. It will not be completed overnight. But we will not begin to restore confidence in our financial markets until and unless we begin serious reform.

— *Joseph Stiglitz, A crisis of confidence*<sup>63</sup>, *The Guardian*, October 22, 2008

Professor of economics at Cambridge, Ha-Joon Chang adds some additional thoughts<sup>64</sup> when commenting on Jeffery Sach's suggestions such as the Tobin Tax and changing emissions trading towards a more straight forward carbon tax. Chang said a lot more could be entertained, including the following:

- The introduction of a country bankruptcy code that will enable orderly sovereign debt restructuring.
- Not just expanding the capital adequacy requirement, but also making it counter-cyclical, rather than pro-cyclical as it currently is (i.e. making credit a bit harder to get during good times).
- Stricter regulations of tax havens and private equity funds, which have greatly contributed to increasing opacity in the financial market.
- Credit rating agencies play a critical role in today's financial system and given the damages they have inflicted by blessing all those toxic assets, these agencies need to be much more heavily regulated or even replaced by an international public body.

Chang also voices concern about IMF reforms, questioning whether trade liberalization for poor countries is *always* good. (He has been one of the more vocal critics of that idea and argues that rich countries developed using more protectionist policies and moved to free trade once they were industrialized<sup>65</sup>, but that they now say poor countries should liberalize straight away, either because of historical amnesia or because they want to “kick away the ladder” they climbed to achieve industrialization. The Institute for Economic Democracy<sup>66</sup> has also suggested this for many years too, and is worth looking at for more depth on the political aspects of economic dominance over the centuries.)

## **Reforming the Bretton Woods Institutions (IMF and World Bank)?**

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The Bretton Woods system of international finance devised by 44 nations after the Second World War, mostly represented by the IMF, World Bank, was designed to help reconstruct and stabilize a post-war global economy.

In the 70s, the purpose of these international financial institutions (IFIs) shifted towards a neoliberal economic agenda, championed by Washington, (also known as the Washington Consensus).<sup>67</sup>

It was at this time that policies such as structural adjustment started to be pushed to much of the developing world, following a “one size fits all” prescription of how economies should be structured, which had disastrous consequences for much of the world's population.

As journalist John Vandaele writes,

From then on the Bretton Woods Institutions (BWIs) were very asymmetrical organisations. The rich countries didn't need the BWIs any more, but with more than 60 percent of the vote they called the shots in both institutions. Developing countries really depended upon the BWIs, but didn't have a lot to say there.

And so the BWIs developed into an instrument of western power.

— *John Vandaele, Bretton Woods II: New Lifeline for Ailing Giants*<sup>68</sup>, *Inter Press Service, October 28, 2008*

The same policy prescriptions led to predictable problems such as

- Developing countries opening markets before they were really ready to do so (something often forced through by “gun-boat diplomacy” during colonial times)
- Rich countries became “judge and party,” as Vandaele puts it: “When they forced developing countries to open their markets, it was no coincidence that western multinationals tended to be among the first beneficiaries.”
- Worsening poverty from things like structural adjustment policies that sapped the ability of poor country governments to make decisions about how their economies would be run.

Although such institutions have rarely been held accountable for such policies and their effects, for many years, people have been calling for their reform, or even for their abolition. Lack of transparency in these institutions has not helped.

There have been signs of discontent, however.

As mentioned on the structural adjustment<sup>69</sup> page on this site, the IMF and World Bank have even admitted their policies have not always worked. For example, back in 2003, they warned that developing countries face an increasing risk of financial crisis with increasing globalization because effects in one part of the world can more easily ripple through an inter-connected world. “Financial integration should be approached cautiously,” they warned. In addition, they admitted that it was hard to provide a clear road-map on how this should be achieved, and instead it should be done on a case by case basis.

While former chief economist for the World Bank, Joseph Stiglitz is now a well-known critic of the IMF/Washington Consensus ideological fanaticism, as also mentioned on that previous page, others at the IMF have also started to question things, noting that developing countries have not benefited from following these ideologies so rigorously.

Fast forward a few years to this financial crisis and there are more calls for reform of the global financial system, perhaps with a difference: the crisis now seems to be so deep and affecting rich countries as well that even some rich countries that benefited from the inequality structured into the global order are now calling for reform. In addition, although developing countries had called for reform many times before, they now have a slightly stronger voice than in the past.

People within the IMF/World Bank are now themselves publicly entertaining the thought of reform<sup>70</sup>. The World Bank's own president, Robert Zoellick has said the idea of the G7 “is not working” and that a “steering group” of more nations would be better.

With the limited role the IFIs have played in this crisis<sup>71</sup>, until recently, it seems their significance may be dwindling. Fewer countries have turned to them as last resort, and when they have, they have been able to push for far less stringent conditions than in the past. Some countries have looked to other countries like China, Russia and Arab countries, first.

There are still some concerns that some countries turning to the IMF will find themselves being prescribed the old formulas that are now quite criticized. Joseph Stiglitz also adds that these financial institutions have been slow to respond in the past and now:

We may be at a new “Bretton Woods” moment. The old institutions have recognized the need for reform, but they have been moving at glacial speed. They did nothing to prevent the current crisis; and there is concern about their effectiveness in responding to it now that it has hit.

It took the world 15 years and a world war to come together to address the weaknesses in the global financial system that contributed to the Great Depression. It is to be hoped that it will not take us that long this time: given the level of global interdependence, the costs would simply be too high.

— *Joseph Stiglitz, Let's throw away the rule book; Bretton Woods II must establish economic doctrines that work in emerging economies as well as in capitalism's heartland*<sup>72</sup>, *The Guardian*, November 6, 2008

French President and head of the EU presidency, Nicolas Sarkozy has called for major changes to the IMF and World Bank<sup>73</sup>. Yet, as John Vandaele added “This is as much a rescue operation for two organisations that have lost muscle as a call for a new financial architecture.”

Sarkozy's ideas include tighter supervision of the international banking system and a crackdown on international tax havens to address harmful tax competition between states. These and other proposals are not new however, as many have called for this—and more—in the past 2 or 3 decades.

As Vandaele also adds, “if Sarkozy is serious about a Bretton Woods II, he'd better keep in mind that developing countries want more voice.” Governance issues such as better representation, more transparency and accountability are some of the things these institutions have long tried to promote, but often faced charges of hypocrisy as these institutions lack many of these fundamentals.

For a while now, talk of G20 meeting rather than just the G8 has signified this possible power shift. The G20 was actually set up in 1999 in the wake of the financial crisis that hit Asia. However, the G8 retained its influence, until now it seems.

The G20<sup>74</sup> represents the G8, the EU as a bloc and 12 emerging economies: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States of America. As well as the EU being represented as a bloc, IMF and World Bank representatives are usually present at G20 meetings.

Although it is an informal structure, it comprises 90% of the world's economic output and some 80% of the world's population, although the poorest 20% (over 160 nations) are not represented by this group.

The United States invited the G20 for a financial crisis meeting in mid-November. As many noted, the meeting

was of the G20 and not the G8, indicated how emerging nations might be gaining more prominence.

While many emerging nations and even some European countries wanted the meetings to discuss fundamental reforms to the global financial system, the US and others wanted to focus on ways to address the current crisis with specific short term measures. These divergent aims<sup>75</sup> threatened to make the talks less effective.

At the same time, a more global UN conference on Financing for Development<sup>76</sup> towards the end of November has received far less media attention. This is to include all 192 member states and is broader in scope, continuing on from the 2002 Monterrey conference.

Some emerging nations such as China are now finding domestic pressures may outweigh their contributions to global resolutions<sup>77</sup>. China for example is being asked by Britain's Gordon Brown to provide billions from its dollar reserves to help out while China is worried about the increasing slowdown in the domestic economy and the need to stimulate its own internal markets. It has therefore poured billions into domestic stimulus packages, implying that it is not likely to provide so much money to institutions such as the IMF.

Some are also wondering whether the resolve of nations such as China to support an alternative to a US dollar dominated world will really hold up; China for example, has benefited from the US development model driven by consumption<sup>78</sup>. It has meant more exports for China. However, now as consumer confidence in the US has been seriously rocked, China is feeling the effects. But if it can see a future where that model is revived, it would benefit. Would it want that to change?

## **Reform and Resistance**

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Will any of these changes occur in an effective way? In recent months these institutions have warmed to changes in these areas. For example, in April 2008, it was decided that rich countries at the IMF would give in 3 percent of the votes; 2 percent went to emerging countries and 1 percent to other developing countries. However, this is still not that much and this crisis shows that more is needed in a more deeper and meaningful way.

This will be hard to predict. If history is any indicator, power and greed politics always ruin good ideas. Those who benefit from a system are less likely to be receptive to change, or want to steer change in a direction that will be good for them, but that may not mean good for everyone.

And tensions, even amongst the more powerful nations are already showing. For example, the US has not invited Spain to a financial crisis summit for mid-November<sup>79</sup>. As the world's eight largest economy and home to 2 of the world's top 16 banks, a meeting of the G20 (G7 plus some developing nations) sees Spain (the world's 8th largest economy) missing out of either classification. Spain, however, sees this as US retaliation for the country withdrawing its troops from Iraq. It has full EU support for being present at this meeting as well as support from a number of Latin American countries. Like France, it wants to see in-depth reform of the global financial system and focuses on IMF reform as well as giving more representation to emerging nations.

The eventual outcome of the G20 meeting seemed mixed. They agreed to use government spending to fight a spreading recession, to tighten lax oversight of markets, to resist protectionism, and to revive stalled negotiations for a new global trade pact. They also agreed to meet at the end of March 2009 to follow up. Developing countries also got more assurances about increased say at international financial institutions through promises of reform at

the IMF and World Bank. But others argued that the meeting outcome seemed more vague than concrete<sup>80</sup> and only these principles seemed to have been agreed without anything more concrete.

The call to resist protectionism has been a prime concern from the Bush Administration, sometimes (incorrectly) equating calls for regulation with protectionism. The calls for regulation have typically been to make companies more transparent and ensure the financial mess created can be avoided in the future. Nonetheless, other regions around the world agree that generally free trade is desirable over protectionist policies. History has shown that once economies mature they benefit from less protectionist measures<sup>81</sup> (but also shows that nations on early stages of development may also benefit from it). The APEC trading bloc, for example, represents almost half of all world trade. Most member states are generally industrialized, so as a group, APEC nations have agreed to resist protectionist measures<sup>82</sup>.

Reform of the IMF and World Bank, however, will be crucial for much of the world. Whether that actually happens and to what extent those with power are willing to truly share power is something that we will find out in the course of the next year.

The promise of rearchitecting the global financial system more fundamentally seemed to wither away slightly. As the *Bretton Woods Project* noted, the G20 had little time to effect much and could not do it alone, any way:

G20 governments, swept off their feet by the financial crisis, were never going to be able to reach a consensus on deeper reforms within the few weeks taken to prepare the summit. Critics argue that the G20 can never tackle this agenda alone.

As Miguel D'Escoto, president of the UN General Assembly said: "Only full participation within a truly representative framework will restore the confidence of citizens in our governments and financial institutions." He continued, "Solutions must involve all countries in a democratic process."

— *International economic architecture: cleaning up the mess?*<sup>83</sup>, *Bretton Woods Project, November 27, 2008*

Hardly mentioned in the mainstream media by comparison, the more democratic alternative was the Doha conference on financing for development meeting<sup>84</sup> at the end of November in Doha, Qatar, held by the United Nations General Assembly. Perhaps partly because of lack of mainstream media attention, the Doha conference also resulted in weak pledges and disappointment<sup>85</sup>.

More generally, as Vandaele also finds,

The most powerful international institutions tend to have the worst democratic credentials: the power distribution among countries is more unequal, and the transparency, and hence democratic control, is worse.

— *John Vandaele, Democracy Comes to World Institutions, Slowly*<sup>86</sup>, *Inter Press Service, October 27, 2008*

Although history often shows that those with agendas of power tend to win out, history also shows us that power shifts. A financial crisis of this proportion may signify the beginnings of such a shift.

And so, it is perhaps only at a time of crisis that more fundamental rethinking of the entire economic system can

be entertained.

## Rethinking economics?

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During periods of boom, people do not want to hear of criticisms of the forms of economics they benefit from, especially when it brings immense wealth and power, regardless of whether it is good for everyone or not.

It may be that during periods of crisis such as now, the time comes to rethink economics in some way. Even mainstream media, usually quite supportive of the dominant neoliberal economic ideology entertains thoughts that economic policies and ideas need rethinking.



Stephen Marglin, Rethinking Economics<sup>87</sup>, May 21, 2007, © Big Picture TV

Harvard professor of economics, Stephen Marglin, for example, notes how throughout recent decades, the political spectrum and thinking on economics has narrowed, limiting the ideas and policy options available.

Some have been writing for many years that while the current economic ideology is flawed, it only needs minor tweaking to correct it and make it work for everyone; a more compassionate capitalism, but capitalism nonetheless. Others argue that capitalism is so flawed it needs complete doing away with. Others may yet argue that the bailouts by large government will distort the markets even more (encouraging bad practices by the big institutions) and rather than more regulation, an even freer form of capitalism is needed.

What seems clear is that at least for a while, debate will increase in the mainstream.

This will also attract ideologues of different shades, leading to both wider discussion but also more entrenched views. Those with power and money are less likely to agree to a radical change in economics where their power and influence are going to diminish, and will be able to lobby governments, produce compelling ads and do whatever it takes to maintain options that ensure they benefit.

It is perhaps ironic to quote, at length, a warning from Adam Smith, given he is held up as the leading figure of the economic ideology they promote:

Our merchants and master-manufacturers complain much of the bad effects of high wages in raising the price, and thereby lessening the sale of their good both at home and abroad. They say

nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people.

...

Merchants and master manufacturers are ... the two classes of people who commonly employ the largest capitals, and who by their wealth draw to themselves the greatest share of the public consideration. As during their whole lives they are engaged in plans and projects, they have frequently more acuteness of understanding than the greater part of country gentlemen. As their thoughts, however, are commonly exercised rather about the interest of their own particular branch of business, than about that of the society, their judgment, even when given with the greatest candour (which it has not been upon every occasion) is much more to be depended upon with regard to the former of those two objects than with regard to the latter.

Their superiority over the country gentleman is not so much in their knowledge of the public interest, as in their having a better knowledge of their own interest than he has of his.

It is by this superior knowledge of their own interest that they have frequently imposed upon his generosity, and persuaded him to give up both his own interest and that of the public, from a very simple but honest conviction that their interest, and not his, was the interest of the public.

The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. **To widen the market and to narrow the competition, is always the interest of the dealers.**

To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens.

**The proposal of any new law or regulation of commerce which comes from this order ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.**

— Adam Smith, *The Wealth of Nations, Book I, (Everyman's Library, Sixth Printing, 1991), pp. 87-88, 231-232*  
(*Emphasis added. Additional paragraph breaks added for readability*)

With the mainstream media<sup>88</sup> often representing such entrenched interests, true democratic participation<sup>89</sup> will be very critical.

## More information

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A **lot** will be written about this crisis as more will certainly unfold. Here are some starting points to read more:

From the mainstream media:

- [BBC](#)<sup>90</sup>
- [CNN Business](#)<sup>91</sup>
- [Bloomberg](#)<sup>92</sup>
- [Credit Crunch](#)<sup>93</sup> section from the Guardian and their section on the 2008 Crash<sup>94</sup>

Other sources

- [Inter Press Service](#)<sup>95</sup>
- [Democracy Now!](#)<sup>96</sup>
- [AlterNet](#)<sup>97</sup>
- [ZNet](#)<sup>98</sup>
- [Articles by Joseph Stiglitz](#)<sup>99</sup>
- [Third World Network on Finance and Development](#)<sup>100</sup>

The above are just small examples, and they will link to yet more resources for further information.

## Where next?

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Related articles

1. [Global Financial Crisis 2008](#)
2. [Poverty Facts and Stats](#)
3. [Structural Adjustment—a Major Cause of Poverty](#)
4. [Poverty Around The World](#)
5. [Today, over 26,500 children died around the world](#)
6. [Causes of Hunger are related to Poverty](#)
7. [Solving World Hunger Means Solving World Poverty](#)
8. [Food Aid as Dumping](#)
9. [Myth: More US aid will help the hungry](#)
10. [Corruption](#)

## Online Sources:

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(Note that listed here are only those hyperlinks to other articles from other web sites or elsewhere on this web site. Other sources such as journal, books and magazines, are mentioned above in the original text. Please also note that links to external sites are beyond my control. They might become unavailable temporarily or permanently since you read this, depending on the policies of those sites, which I cannot unfortunately do anything about.)

1. <http://uk.youtube.com/watch?v=mzJmTCYmo9g>
2. <http://uk.youtube.com/watch?v=egIEo8Pmg7c>
3. <http://uk.youtube.com/watch?v=st3BLOKtvnA>

4. 'What's really burning down the financial house. Derivatives are out of control. Time for adult supervision.', Christian Science Monitor, November 5, 2008,  
<http://www.csmonitor.com/2008/1105/p09s02-coop.html>
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by Anup Shah

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"When I give food to the poor, they call me a saint. When I ask why the poor have no food, they call me a communist." — *Dom Helder Camara*

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## Document Revision History

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Date	Reason
December 7, 2008	Short note added on Keynesian economics and the Doha financing conference.
November 30, 2008	Added some videos to explain the financial crisis further. Also added notes on what some nations are now doing to address the crisis as well as info on the potential for increasing say by emerging nations in global affairs.

<b>Date</b>	<b>Reason</b>
October 29, 2008	Updates to include more actions attempted in wake of the crisis, more on how developing countries will fare, more on the crisis in context with other issues, and on banking and IMF/World Bank reform.

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