Global Economic Crisis
International Implications

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Causes & Triggers

- Did <u>not</u> come as a shock - establishment expected imminent economic crisis in 2006.
- Reaping the consequences of the Nixon shocks of the early 1970s - $US off the Gold Standard, de-regulation of global capital, floating exchange rates.
- Financial liberalisation underprices risk (externalities), leads to regular systemic failures & major crises.
- Reckless lending practices by private investment banks in US & Europe (sub-prime mortgages) to consumers who want instant rather than delayed gratification. US housing bubble burst.
- Accumulated debt, including toxic debts ($US3 trillion or 3.5% off global GDP) - defaults led to global liquidity crisis. $US50 trillion wiped off global assets. Foreign debt (China).

Causes & Triggers continued ...

- Speculation on the financial casino for instant super-profits rather than prudent, long-term investment in productive industries (the real economy). Investment (speculation, leveraged) v establishment (probity) banking.

- Opaque, innovative financial instruments (credit derivatives, CDOs, binary options, credit default swaps, etc) & structured investment vehicles used by hedge funds are extremely risky, incredibly complex & unregulated - no copyright on financial instruments.

- Naive faith in an alleged self-correcting market - neo-liberal ideology. Elite consensus.

- Failure of international financial architecture - IMF, WTO, World Bank, G20.

Policy Implications

- Restoring liquidity, public confidence in capitalist enterprises and financial structures, acceptance of regular systemic crises, role for government (nationalisation?) & market.

- If Keynesian pump-priming doesn't work, what policy instruments remain? Monetary policy? Socialism? Destruction?

- Who will lead? The US remains essential but does it have global authority?

- Complex, opaque, exotic financial instruments & securities (CDOs, binary options, credit default swaps, etc) used by hedge funds defy understanding & have been several steps ahead of regulators. Systemic stability v innovation and competition in the market.

- How do you regulate greed, avarice, speculation, competition, ignorance, accidents, happenstance, stupidity, illusions, etc,?

- Free market mythology has disguised the permanent role of the state in the economy (US - agribusiness, military-industrial sector, IT, aviation, pharmaceuticals, etc).

Policy Implications continued ...

- Economists confuse & conflate predictions for the way people *should* behave with the way they actually *do* behave.

- Assumptions that human motivations are utterly calculable and immune to greed, group influence, illusions or ignorance are false (eg Quants). There are too many contingencies, variables & unpredictable events (eg Black Swans).

- Economic history stresses the agency of politicians & the crucial role of the state in economic development & policies - market economics does not.

- Will the opportunity for reform of global financial regulation and changes in the governance of the global economy be taken (G20, IMF)? The urgent need for a <u>world financial authority</u>: *"In a world of open financial markets, national governments cannot effectively regulate the financial risks to which their societies are exposed. That can only be done by an international body with policymaking and policy-enforcing powers"* - John Eatwell & Lance Taylor.

Systemic Implications

- Rational management of the financial system is impossible because it is too complex for human understanding - no-one knows how capitalism actually works. There is no higher capitalist logic directing affairs.
- How to manage anarchy in the world economy (de-regulation & liberalisation)? The market isn't "self-correcting". What if this isn't a cyclical crisis but a permanent one?
- Collapse of neo-liberalism and resurrection of state capitalism. Role of the state in saving the system and bailing out major players comes at the cost of greater regulation and the abandonment of market purity (ideological contradictions).
- Moral hazards and risk management? The *privatisation of profit* and the *socialisation of risk* - bailing out the incompetent & the rich.
- Legitimation crisis - from a collapse in confidence & commitment to "civil unrest" (IMF) - the end of elite support for globalisation + popular opposition?

Systemic Implications continued ...

- No failsafe mechanisms to prevent a “great unwind” - the system is inherently unstable and beyond coherent, rational management. No-one can explain why things suddenly & unexpectedly go wrong.

- Claims such as “market corrections”, “economic cycles”, and “risk management” are illusions, arguably necessary for legitimacy & confidence but remain illusions.

- Manias, panics, crashes & crises are endemic - *Savings & Loans* (early 1980s), *Long Term Capital Management* (1998), *dot.com* collapses (mid 1990s), *Enron* ($US100 billion lost in 2001), *Armanth Advisory* (lost $US 6 billion or over 60% of its assets in a week in 2007), *Bears Stearns* (lost $US30 billion in 2008), *Lehman Brothers* (lost $US5 billion+ in 2008), etc,.

- The resources of governments are limited, as is the patience of taxpayers.

Geo-political Implications

- IMF warns about the rise of poverty in Africa & "civil unrest, perhaps even a war."
- Unemployment, widening class divisions (eg Pacific Brands goes to China).
- The US is indispensable to economic recovery, but will emerge diminished in moral authority & economic power. It's capacity for foreign adventurism will be constrained (greater burden-sharing in Afghanistan & Iraq will be expected).
- Growing protectionism & economic nationalism <u>or</u> the WTO Doha round?
- De-globalisation? In trade & finance yes (temporarily?), not in communication, technology or culture.
- Collapse of elite consensus <u>for</u> globalisation in the West (demise of Davos man)? Is global economic integration really the shortest path to rising prosperity?