FINANCIAL CRISIS AND ALTERNATIVE PARADIGMS

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Social Watch Workshop
Pathways to Regional Development
Manila, Nov 25-27, 2010

OUTLINE

Why the Great Financial Crisis (GFC) Happened?
What do we do and What Alternative Paradigms do we have?
What are the organizing principles of these paradigms

3 Levels of Causes of GFC
1. Failure of Neo-liberal, Market Fundamentalist Ideology
2. Financial Deregulation/Liberalization
3. Macro-economic Imbalances
   - Trade Imbalance
   - Financial vs Real Economy Imbalance
   - Income and Wealth Imbalance

Market Fundamentalism
- Market forces (demand and supply) always gives the best equilibrium price
- Market is the most efficient allocator of resources
- Market can self-regulate

Failures of Market Fundamentalism
- Market forces more applicable to consumer than investment goods
- Investment decisions deals with uncertainty of future; insatiable
- Prices determined by animal spirit
- Excesses lead to resource misallocation

Animal Spirit and Certitude of Uncertainties
- “There is nothing so disturbing to one’s well being and judgment as to see a friend get rich.” (Kindleberger,2000:15)
- “I can calculate the motions of the heavenly bodies, but not the madness of people.” Isaac Newton (cited in Kindleberger:31)
Soros & Ackmermann on Failures of Markets

January 23, 2008, George Soros:
• “Fundamentalists believe that markets tend towards equilibrium and the common interest is best served by allowing participants to pursue their self interest. It is an obvious misconception, because it was the intervention of the authorities that prevented financial markets from breaking down, not the markets themselves
• March 14, 2008, Josef Ackermann, CEO, Deutsche Bank: “I no longer believe in market’s self-healing power”

Financial Deregulation

• Deregulation under Reagan and Thatcher
  • Financial deregulation:
    ▪ Interest rates ceiling lifted > competition
    ▪ Interstate banking allowed > don’t serve local economy
    ▪ Wall btw commercial and investment bank broken down

2 important Financial Deregulation Acts

• 1999- Repeal of Glass-Steagal Act replaced by Rudd-Graham Act > universal banks and shadow banks
• 2000- Commodity Futures Modernization Act – derivatives, not a security and not gambling. Hence no regulation

Deregulation and Financial Innovations

• Huge increase in Leverage of Banks from 12 to 30 times > Time Bomb
• Derivatives – weapons of mass destruction
• Derivatives rose from $100 trillion to $514 trillion (2002-2007) > housing, commodities
• CDOs, CDO2, CDS etc > subprime bubble
• Subprime crash > food crisis

Food Price Index 2005-2010

• Rise and Volatility in fuel and food prices not due to demand and supply only
• Large part due to speculation
• 2005-2008
• Food price rose 83%, Maize 300%, Wheat 127%, Rice 170%
• Surge in prices 2007-08 pushed 130-150 million into poverty
Growth and Growing Inequality – World Wide

- US a Banan Republic – Gini index of 46 similar to many Third World countries
- 2007 – Top 1% earned 24% of total income
- Bottom 20% earned < 5%
- World
- 2008 – 1250 billionaires worth $4.4 trillion
- Top 2% of world richest own 51% world’s assets

Inequality – Neglected Imbalance in Financial Crisis

- Income Share of Highest Income Households At Highest Level Since 1928

CEO’s vs Workers’ Wages

- 1990-2005,
  - Minm wage minus 9%
  - Prodin Workers Pay + 4%
  - Corp Profits + 107%
  - S&P 500 +141%
  - CEO’s Pay +300%

Wages Fall Behind Productivity Gains

- Relation between Inequality & Financial Crisis
  - Creates 2 types of bubbles:
    - Debt Bubble
    - Asset Bubble
  - Majority with low consumption power, resort to debt to buy & to power economy
  - Tiny minority with excess savings, chase for high yields & increase risk appetite
  - Financial system feeds & benefits fr these

What Do We Do?

- Remedies must be rooted in causes –
  - Need new paradigm(s) to replace market fundamentalism
  - Need to regulate and pull back finance to serve not be master of real economy
  - Need to correct growing inequality
Short and Medium Term

- Banks focus on lending
- Regulate speculation strictly
- Introduce finance transaction tax, accelerated capital gains tax
- Restrict commodity futures markets to genuine investors
- Regulate capital flows
- Ban corporate lobbying and contributions

Medium Term – Redefine Human Progress

- Definition matters – increase momentum to redefine terms and indicators of human progress
- Progress is more than GDP, must include social, political, cultural indicators
- Bhutan and Gross National Happiness

Long Term – Alternative Paradigm

- Choice not just between Capitalism/Market Fundamentalism vs Communism/Central Planning
- Failure of both extremes
- Need both market and planning – mixture of both depends on local, national context
- Not one model but different models

Zapotec Indians & Sustainable Forest Mgt

- Forest communally owned; decisions made by general assembly of 390 townspeople
- All required to contribute labor to regenerate forest
- 30% profit plough back; 30% forest preservation; 40% to workers/owners

Limits to Unsustainable Growth

- Paul Gilding, environmentalist:
  - “No matter how wonderful the system is, the laws of physics and biology still apply”
  - We must grow in sustainable ways. Instead of hyper-growth, we must have sustainable growth where the concept of net-zero applies - i.e. resources are recycled and reused rather than discard.

Observation of Gandhi

- The measure for the level of progress of a civilization is not how much desires and wants it can create and satisfy, but how much desires they can control.
### Principles of Alternative Paradigms

#### Organizing Principles
- Capitalism
- Communism
- Socialism
- Gandhian Buddhism

#### Nature of Human
- Economic Animal
- Object in History
- Subject in History
- Social Spiritual being
Principles of Alternative Paradigms

Social & Political
Electoral democracy
Hijacked by lobbyists
Military industrial complex
Finance capital

Electoral democracy
One party state
Bureaucratic control
Electoral democracy
Welfare state

Electoral democracy

Reverse the Great Transformation

• Apply principles from alternative paradigms as we work in existing system
• In the Great Transformation - everything was commoditized
  • Man became labor
  • Trees became timber
  • Land became real estate
• We need to reverse the Great Transformation

• THANK YOU