

Annex K

FINANCIAL CRISIS AND ALTERNATIVE PARADIGMS

Michael Lim Mah Hui
Social Watch Workshop
Pathways to Regional
Development
Manila, Nov 25-27, 2010

1

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

2

3 Levels of Causes of GFC

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

3

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

4

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

5

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)

6

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"

8

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

8

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

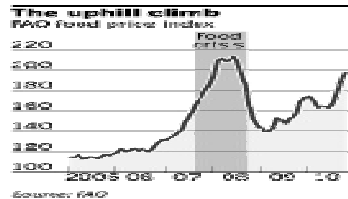
9

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

10

Food Price Index 2005-2010



Relation btw Financial Speculation and Food Prices

- 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

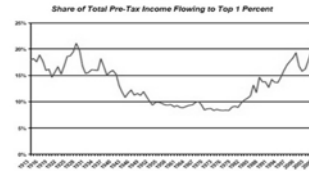
12

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

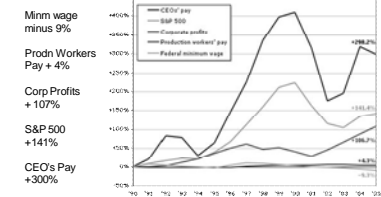
Inequality – Neglected Imbalance in Financial Crisis

Income Share of Highest Income Households At Highest Level Since 1928

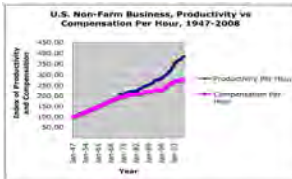


CEOs' vs Workers' Wages

- 1990-2005



Wages Fall Behind Productivity Gains



16

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

18

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

19

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

20

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

21

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

22

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.

23

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.

24

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

26

Principles of Alternative Paradigms

Concept of Nature	Control and subjugate	Similar to capitalism	Exist in harmony with nature
-------------------	-----------------------	-----------------------	------------------------------

26

Principles of Alternative Paradigms

Economy	Production For Profit	Production For Use Expression of Spirit	Production for Use Expression of Spirit
	Large scale production And Organization	Same as capitalism To catch up with capitalism	Small scale production Self sufficiency

27

Principles of Alternative Paradigms

Economy	Industrialism	Same as capitalism	Agriculture and limited industry
	Hyper growth Consumerism	Growth and consumption	Simplicity in life style

28

Principles of Alternative Paradigms

Economy	Top down management control	Communism - top down bureaucracy Socialism - workers control	Self employed Simple organization
	Market driven	Central Plan State Regulation	Small scale perfect competition

29

Principles of Alternative Paradigms

Economy	Gross Domestic Product	Gross Domestic Product	Gross National Happiness (GNH)
	Inherent inequality	Redistributive equality	Compassionate Distribution
	Deregulation, Free capital movement	State Regulation	Some government intervention

Principles of Alternative Paradigms

Social & Political	Electoral democracy Hijacked by lobbyists Military industrial complex Finance capital	One party state Bureaucratic control Electoral democracy Welfare state	Electoral democracy
--------------------	--	---	---------------------

31

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

32

- THANK YOU

33