LOK SAMVAD

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EDITORIAL

Bursts the Economic Bubble, Vanishes the Great Economic Power !

-Piyush Pant

Look at the following—

- In U. S , the total consumer debt is growing 23 times faster than the entire economy
- The savings rate in U.S. has dipped into the negative which had never occurred since the Great Depression in 1932
- U.S. dollar has lost half of its value in the past 10 years
- In U.S. the unemployment rate has taken the biggest jump since 1986. It jumped to a 16-year high of 7.2 per cent. The country lost 524,000 jobs in 2008 alone. The growing army of unemployed, at 11.1 million, is nearly 50% higher than at the start of the recession a year ago.

These statistics tell the story of a country whose economy was supposed to be invincible, the country about which the common perception and prediction was that in the next 10 years household wealth in North America will double, exceeding 100 Trillion dollars, thus creating more millionaires than at any other time in the history of U.S. But the bitter truth is that the U S economy has reached its nadir – it has become recessionary and there is large scale closures and retrenchments. The latest figures show that American companies reported as many as 65,000 job cuts in a single week alone. What is worst is that the recent ILO report has painted a gloomy picture even for the world economy. It has predicted a frightening scenario in which 51 million more jobs could be lost by the end of 2009, leading to a 7.1 percent global unemployment rate. What a pity for the economy which once ruled the world and for those financial institutions and corporates who were supposed to be giants never to fall by the way side and whose each and every stride was praised and emulated in a sacrosanct manner !

But lo and behold! Within weeks these giants got wiped out in the bankruptcy storm that was created by over indulgence in derivatives, housing credit and sub-prime mortgage. Overnight, big players like Merrill Lynch, Lehman Brothers, AIG, Bear Sterns, Countrywide Financial, Fannie Mae, Freddie Mac, Wachovia and Washington Mutual became not only dwarfs but some of them becoming even non-existent. Twenty-five U.S. banks failed in the year 2008, much more are expected in the year 2009 amid the pressures of tumbling home prices, rising mortgage foreclosures and tighter credit. Some may have to merge with other institutions. A number of banks have failed and have been shuttered in recent months in California which has especially been battered by mortgage and housing crises. Seattle-based thrift Washington Mutual Inc. failed in late September 2008 and this was the biggest bank collapse in the U.S. history. It had 307 billion dollars in assets. Later, Washington Mutual's deposits, branches and loan portfolio were bought by Wall Street powerhouse JPMorgan Chase & Company from the FDIC for 1.9

In This Issue

billion dollars. Investment Institutions' bankruptcy has come to such a pass that since October 2008 U.S. Treasury Department has been using most of the first half of the 700 billion dollar Federal bail out fund to buy stocks in the banks and other financial institutions, with the idea that cash injections will spur banks to get lending again.

The Global melt down has once again proved the fragile nature of the economic system which is usually fed on the artificial hype of the capital productivity.There is always a tendency to create a bubble and keep it ballooning till it finally bursts, resulting in massive devastation in terms of bankruptcy of financial institutions and big corporates, economic recession and individual suicides. The logic of burst is inherent in it. The US economy has been castigated for this by many critics. As Stephen Roch, the chairman of Morgan Stanley Asia says-"Wth its "monstrous bubble of cheap credit ….with one bubble begetting another, America's bubbles have gotten bigger, as have the segments of the real economy they have infected". If we closely watch the course of the rapid march of U.S economy to its glory we find that it keeps on faltering periodically as has been pointed out by Tom Harris: "The US has an economic pattern. The United States' economy will expand for six months until ten years and then enter a recession for about six months or two years". Similarly rate of unemployment keeps increasing and then declining. The unemployment rate had reached 10.8 percent in the 1981-82 recessions which was at the highest level since World War II. In those years, unemployment and economic growth rose and fell more or less in tandem. But in the early 1990s all this changed. For instance, employers continued to shed jobs for months during 1990-91 recession and again after the 2001 recession which was so severe that employment did not return to its pre-recession level for four years.

In fact a certain type of hype and aura is created around the capitalist mode of production beneath which lies the gradual slow down or even stagnation as the non-productive capital pushes the productive capital to the sideways resulting into economic activities amounting to speculation. As the writer John Bellamy Foster points out-"The bursting of the two major financial bubbles in seven years in the citadel of capitalism points to a crisis of financialisation, or of the progressive shift in gravity from production to finance that has characterized the economy over the last four decades". If the economic depression of 1930s was a severe blow to the development agenda of the north, the economic burst of the bubble has put the pace of economic growth to a standstill. Yet, Capitalism always has its answers. So a wider market was developed through the creation of WTO which laid the trading rules and structures for the global economies. But as the favourable conditions waned, stagnation resurfaced in 1970s. Manufacturing capacity utilization began its decline that has continued to the present, averaging only 79.8 percent in the 1972-2000 period (as compared to an average of 85 percent in 1960-69). Partly as a result net investment faltered. In April 2003 US manufacturing registered its weakest showing since October 2001 giving indication that America's business sector remains a drag on the economy. The world's largest economy only grew at an annual rate of 1.6 % in the first three months of the year 2003.

The interesting fact is that there is a common bond among the 2008 Fiscal Meltdown, the Great Depression of 1929 and the East–Asian crisis of 1997. In all these crises, the real-estate sector has been the real culprit precipitating the crisis. For instance, the 1929 crisis was the result of bursting the 'South China Sea's bubble" where unscrupulous middlemen sold non-existent real estate in the South China seas. Similarly East-Asian crisis was caused by dubious real estate purchases by "friends of " bankers and politicians which was called the "crony capitalism". The present crisis also had this element of real estate market crashing in the US. The roots of this crisis can be traced to another notable phenomenon of boom and bust i.e. the tech. bubble of the late 1990s. When the stock market began a steep decline in 2000 and the nation slipped into recession in the year 2001, the Federal Reserve sharply lowered the interest rate to limit the economic damage. Lower interest rates make mortgage payments cheaper, hence demand for homes began to rise, sending prices up. Besides millions of homeowners took advantage of the drop in rates to refinance their existing mortgages. As the industry ramped up, quality of the mortgages went down.

And then default and delinquency rates began to rise in 2006 but the pace of lending did not slow. Banks and other investors had devised a plethora of complex financial instruments to slice up and resell the mortgage-backed securities and to hedge against any risks. But all their calculations fell flat.

Global Financial Crissis - A Clasic 'Ponzi' Affair?

By: Sunanda Sen

The turmoil in the US financial market and its spilling over to financial markets overseas has made it once more evident that we need to scrutinise the validity and relevance of the neo-liberal theory and policies which brought about this mess.

We try in the following pages, to interpret the crisis: first, by identifying the two special characteristics of the current crisis which also explain its intensity. We also look into the dominant precepts behind, an uncritical acceptance of which has led to policies as can be held responsible for much of the current malaise in the financial sector. These are the mainstream or neo-liberal economic doctrines to achieve what were considered as "efficient" financial markets. Second, we interpret the unfolding of various bankruptcies and bailouts in the US financial sector which have come out in public domain. Finally, we pay attention to the actual and potential threats for a similar crisis as seem to prevail upon India.

What Triggers a Financial Crisis?

To get at the background of the US (and currently the global) financial crisis one needs to address the following two major issues: First, the prevalence of high stakes in the financial markets under uncertainty with risks involved in holding assets often disproportionately high as compared to their realised returns. Such transactions have been identified in the literature as Minskian 'ponzi' deals, which, as was pointed out by the post-Keynesian economist, Hyman Minsky in 1986, are both unsustainable and hazardous as compared to acts of simple hedging or even speculation on asset prices in markets.

With ponzi finance, the high returns as are offered to entice the new investors to lend and invest are often not realised in the market by the borrower. To avoid an impending default and an interruption of business, it is not only necessary for new investments as above to continue but also these need to be adequate to compensate the losses as are incurred on previous investments. However, as confidence on these assets is gradually eroded, these transactions come to a grinding halt, leading to big holes in the balance-sheets of the concerned parties. The pattern with ponzi finance as above is very different from hedge finance which to some extent keeps the system going as long as hedging offsets the losses against possible gains. Even speculatory finance, which dwells on more risk than under hedging, can be sustained until it becomes ponzi, when borrowings at high rates no longer generates equivalent returns, a situation which is currently on in the US financial markets.

The second factor which contributed to trigger the recent financial crisis relates to financial innovations in de-regulated financial markets. By generating derivative instruments which aimed to protect asset values in uncertain markets, derivatives also made it possible to invest and acquire assets much more easily. Thus, with 'futures', a typical derivative product which arranges a contract towards the sale and purchase of an asset in some future date, the deal can work to the convenience of both the buyers and sellers involved by insuring against the uncertainties in the market, while dispensing with cash transactions at the time of the contract. Thus the buyer contracting a 'long' (buying) position deposits only a fraction of the contracted price as 'margin', with the exchange trading organisation (usually a security exchange). Innovations and instruments as above in the financial sector have opened up vast potentials for expanding financial market transactions which are no more constrained by availabilities of bank credit. However, transactions as above and the agents involved can remain in business as long as the hedging works to minimise the risk under uncertainty and the risk-adjusted returns offered to those with long (buy) positions are realised by those who hold the short (sell) positions on assets. These may not materialise in a typical 'ponzi' situation, as described above.

It now remains to be seen as to how aspects as above are handled in mainstream theory and policy with its advocacy for wide-ranging de-regulations in financial markets. By postulating rational expectations and access to full information for all agents in the market, uncertainty, in terms of these theories, does not get in the way of achieving efficiency when markets are left free. Accordingly, speculation under uncertainty is reduced to arbitrage (in point of space) and hedging (in point of time) and the market is supposed to take care of uncertainty-related concerns by using financial derivatives. From this angle financial markets perform the best when there is no restraint on trading, both in spot markets and in those for derivatives. In case lenders are wary of potential defaults by borrowers which may be due to incomplete or asymmetric information in the market, they resort to credit rationing, as held in the literature. But both borrowers as well as lenders are still viewed as rational beings who decide feely on their lending or borrowing activities in the market.(2) Positions as above, emanating from advanced countries, have continued to dominate policies in financial markets and the financial institutions.

However, the magnitude and the intensity of the happenings in the USA and elsewhere seem to have jolted a bit the entrenched positions held by the establishment with efforts to bend the standard rules of monetarism and free markets under capitalism.

Otherwise how can one interpret the huge bailout packages from the state in a country or countries which always have been strong advocates of free-market capitalism?

Financial Markets - What All have gone Wrong in US Financial Markets?

Back in the 1970s, the US economy was subjected to an unprecedented wave of credit squeeze as the Fed Chairman, Alan Greenspan, launched a series of monetarist strategies to contain inflation. Reacting to above, financial innovations led the way to credit creation beyond the usual banking orbits. Thus a large number of US firms started having access to short-term credit by using, as collaterals, securitised assets like commercial papers. As the wave of securitisation (of assets) caught on, new forms of financial intermediation were provided by investment banks which lent their expertise in re-packaging the securities which were now marketed easily and sold to other banks or non-bank financial units that included the investment banks as well. Since these transactions were outside the orbit of conventional banking channels, the Fed had no regulatory power over these. Instead, these were subject to the jurisdictions of the US Securities and Exchange Commission (SEC). One witnessed, as a consequence, a 50% decline in the proportion of US financial assets as were held by banks between 1950 and 1990. Credit and transactions related to securities were made easy along the non-banking channels, with rates charged at much lower spreads as compared to those along conventional banking channels. Transactions as above facilitated the churning of multiple asset-backed securities (ABS). These were generated on the basis of the original (or underlying) asset, propping up multiple counterparties which held those assets. Leveraging played a major role in the creation of these debt financed assets, which continued as long as there was trust and confidence in the uncertain markets on these newly created financial assets.

Mortgages on property opened up new profit opportunities in the financial sector, by creating a market which targeted the section of US citizens who had so far been financially excluded on grounds of race and/or income, while banks followed credit-rationing which ruled out such loans. Possibilities to securitise the mortgaged assets opened up new channels of investments for the broker-mortgage firms, the issuers and insurers of asset based securities (ABS), investment banks who readily purchased and repackaged the ABS, and other financial institutions. Each, by acquiring an asset, were able to leverage by obtaining credit against the latter.

As the process continued, a large number of people with low incomes were now endowed with a mortgaged property and a liability to pay monthly instalments, usually to the broker mortgager-cum-bank who organised the deal. These assets were backed by loans which later were discovered as 'sub-prime', with the mortgaged collaterals subject to valuation in a sliding market and with little accountability of the borrowing parties, many of whom were not even bankable in terms of conventional practices. The initial euphoria, fed by the rising property prices on the one hand and the eagerness on part of the financial community to profit by using the securitisation route which temporarily shifted the risk to counterparties, did work as long as the former lasted. The business, as led by investment banks, as mentioned earlier, was outside the purview of the Fed, and the SEC did not find any reason to interfere.

To follow the sequence that led to the recent sub-prime crisis of the US we provide below a rough sketch of the possible links in the system:

The above schema of sub-prime loans which prompted the upswing in the asset market failed to work within a few years. High property prices of the mid-1990s made possible the advances against mortgaged houses at interest rates higher than the market rate to low income borrowers who had very little credentials in the financial market. Repackaging of these to back securities (which exchanged hands to generate further assets and sources of credit) finally proved to be an Achilles' heel by impairing the credentials of the entire financial system in the USA and elsewhere. Use of futures and other derivatives (swaps, options etc.) augmented the scale of operations by making it possible to bid on positions in the security market with small margins of the final transaction until full payment when the contract matured.

To recapitulate the sequence as above, it may be worthwhile to follow the following stages of the upswing in the financial market and the subsequent stages of the reversal:

The Build-up of the Boom

1. Loans advanced by banks, via broker-dealers of mortgages, to borrowers in housing markets at sub-prime rates. Borrowers committed to regular instalments to parties as above.
2. Mortgaged assets get repackaged by issuers of securities as collateralised debt obligations (CDOs) which are the ABSs (or mortgage backed securities) sold to investment banks who sell these to other financial institutions.
3. Market prices of these financial assets determine the returns to the investor.

The Approach to the Crash

1. Drop in property prices, house-owners fail to service debt, announce foreclosure of the mortgage

deal.

2. Issuers of ABS and investment banks face losses due to non-payment by borrowers, facing losses which are aggravated by sharp declines in ABS prices in the market.
3. Losses for other FIs who hold such assets as above.

To continue, a major financial crisis in the US first hit the hedge fund Long Term Capital Management (LTCM) in September 1998 when it was rescued by the Fed which injected $3.6 billion to help out its excessive leverage ratio. A sense of doubts and failing trusts continued and intensified over the next decade until it reached a climax by the third quarter of 2008 when two major investment banks (Fannie Fae and Fredie Mac) were taken over by the Treasury and another major investment bank, AIG, was recapitalised by the Treasury with an injection of $85 billion against 80% equity stake with AIG, all happening in the first two weeks of September 2008. The AIG deal was to protect the biggest insurance agency and investment bank in the country which by this time owned a trillion dollar assets spread over 130 countries and a $441 billion exposure to credit default swaps. Loans by the Treasury to AIG were supposed to carry a rate of interest of 11.5%, to be paid back by selling its assets within two years. In between another big investment bank, the Lehman Brothers, went bankrupt on September 12. By September 11, funds injected by the Fed in the financial market were around $900 billion, a sum which has kept on rising by each day as the market fell further. The latest move by the Treasury to pump in a huge sum of $700 billion and its ratification by the US legislators and even the rate cuts by most central banks in OECD is yet to bring about a reversal of the downswing in asset valuations and a general recessionary trend in the global economy. A steep rise in call money rates for inter-bank lending and a sharp fall in yield on US Treasury bonds, considered so long as safe investment, are aspects which speak for themselves. In all, the story reflects a scene of greed and miscalculation as is typical when it ends with a ponzi strategy.

How does it affect the Indian Economy?

As with other developing countries which today are closely integrated with overseas markets, India at the moment faces considerable risk of a severe downturn as a consequence of the global financial crisis. The reasons include at least the following factors which we briefly mention below: First, the free play of FII investors since 1993 when India's stock markets were thrown open to such investors. Speculatory flows as above have been responsible for phenomenal expansions in the country's stock markets, with capitalisation as well as P/E ratios moving up to unprecedented levels. Second, the extensive use of derivatives on a legal basis in security exchanges and as OTCs led to rapid increases in their use, especially after 1992, when much of these were legalised. Derivative trading in the futures market has been at least six times the turnovers in spot trading at the National Stock Exchange till the meltdown started in these markets. Third, foreign presence in the capital market has been prominent, especially with FII inflows in the secondary markets for stocks, which not only contributed to the rising turnovers but also to vulnerability in terms of sudden flight of capital. The rising level of official reserves, to the extent propped up by these inflows, are already facing a depletion. These have also affected the exchange rate of the rupee, currently heading a downward spin, despite efforts on part of the monetary authorities to manage the rate. Fourth, with both banks and corporates having a considerable exposure in the global equity market it remains one of the imponderables as to how much the balance-sheet of these financial and industrial units would be damaged by the global financial melt-down. Finally, with the onset of recessionary forces in the real sector of the advanced nations, export markets will be generally hard hit for countries like India. Also the expanding jobs and services, as are related to the outsourcing by foreign companies and the Business Processing Organisations (BPOs) as well as the subsidiaries, would get a jolt.

One ought to feel positive about the economy with the confidence and positive thinking on the part of policy-makers in India, currently devising ways to avoid the contagion effects for the domestic economy. It may not be as simple and easy, however, for the country to come out unscathed in the current global scenario which has been described as financial tsunami! It is even less likely that the world's financial markets and its economies will be immune to such shocks in future if the prevailing norms of de-regulated finance remain unchanged. After all, even a top billionare like Warren Buffet was convinced to make a statement in 2002 that "...derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal"!

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Global Economic Crisis

By Dipankar Basu

I

The global economic crisis is, by all accounts, the deepest economic crisis of world capitalism since the Great Depression. It is necessary for the international working class to understand various aspects of this crisis: how it developed, who were the players involved, what were the instruments used during the build-up and what are it's consequences for the working people of the world. This understanding is necessary to formulate a socialist, i.e., working class, response to these earth shaking events. I will share my understanding of the on-going crisis as part of the larger collective attempt to come to grips with the current conjuncture from a socialist perspective, to understand both the problems and the possibilities that it opens up.

The Big Story

The current crisis can possibly be fruitfully understood if measured against different time scales: the short-term, i.e., in terms of days and weeks; the medium-term, i.e., in terms of months and years; and the long-term, i.e., in terms of decades. This analytical compartmentalization into three different time periods is useful because it demonstrates how long-term trends silently but inexorably created the conditions for the medium-term problem to explode into the short-term problem that has buffeted the economy since mid-September, 2008.

In the short-term, the current financial meltdown is a severe credit crisis, a situation whereby financial institutions have become unwilling or unable to lend and borrow among themselves thereby freezing the flow of credit in the entire economic system; this credit freeze is largely fuelled by a serious loss of faith in financial institutions and in the financial system as such and came to the fore most forcefully in the middle of September, 2008. It is also possible that the credit freeze, and the underlying loss of faith, might explode into a full-blown banking crisis: banking panic leading to run on even healthy and solvent banks.

In the medium-term, the crisis is the unravelling of a stupendously leveraged speculative bubble on real estate that built itself up for about seven years from the beginning of this decade (and century); this speculative bubble was mediated by fancy financial instruments fashioned by Wall Street, running all the way from sub-prime mortgages, asset backed securities (ABS) and mortgage backed securities (MBS), collateralized debt obligations (CDO) to credit default swaps (CDS); this speculative bubble led up to and culminated, when it finally burst in the middle of 2007, in the credit crisis that the US, and gradually the global, economy finds itself in.

From a long-term perspective the present crisis is, of course, more than just about Wall Street and finance and banking; it is a full-blown crisis of the neoliberal turn in capitalism inaugurated the 1970s. Neoliberalism (or the neoliberal counterrevolution) was a response to the structural crisis of capitalism that emerged in the late 1960s. It was a response from the point of view of the upper fraction of the capitalist class, a fraction especially dominated by financial interests. The neoliberal counterrevolution ushered in a capitalism firmly under the sway of finance capital; the neoliberal policy turn was geared towards breaking the power of labour vis-a-vis capital that had gradually built up during the two decades after World War II. The result was stagnant real wages, slow but growing productivity, and hence growing profit incomes especially of the financial sector, increasing financialization and a deregulated economy for finance to operate in.

Stagnant wages created the demand for debt from a working class used to growing consumption spending; huge profit incomes and the shredding of all regulation on finance created the supply. The result was a growing role of debt in the lives of the working class which, over time, led to a huge debt overhang on the entire economy. As the ratio of outstanding debt to income rose, with stagnant incomes for the majority, the financial fragility of the entire system increased; and it is this systemically fragile financial architecture that finally cracked under the weight of the bursting housing bubble. Thus, the long-term build-up of debt in the US economy resulting from the neoliberal counterrevolution, which increased the financial fragility of the system, created the conditions in which the bursting of various asset price bubbles could lead to a severe credit crisis and loss of faith in the entire financial system.

Impact on the Real Economy

Real GDP figures released by the US Bureau of Economic Analysis (BEA) on October 30 indicated that the US economy was in the midst of a slowdown even before the financial storm hit the world economy in the middle of September. Real GDP in the US contracted at an annual rate of 0.3 percent for the third quarter (i.e., for the months of July, August and September), led by a sharp fall in consumer spending. The financial storm, comprising a severe credit crisis and even a possible banking crisis, will only deepen

the slowdown and might even push the US and the rest of the world into a prolonged and painful recession, possibly even a decade long L-shaped recession like the one that Japan witnessed during the lost decade of the 1990s. In such a scenario, fixing the financial mess, dealing with the credit freeze, averting a possible run on the commercial banking system and restoring confidence in the financial system will not be enough to prevent a plunge into a deep, prolonged and painful recession; addressing the credit crisis is necessary but not sufficient to deal with the grave crisis in the real sector. An aggressive fiscal intervention by the US government and other governments around the world, in terms of direct expenditure on goods and services, will be necessary to prevent the slide into a prolonged recession. It is in the interests of the working class to push for such intervention even as it works towards re-building it's political, social and economic institutions.

II

Short-term: The Sequence of Events

Even though the credit crisis attained dangerous proportions only in mid-September, it had already announced itself in the early part of the year with the collapse of Bear Stearns, one of the five famed investment banks that defined Wall Street; today none of those five investment banks - Bear Stearns, Goldman Sachs, Lehmann Brothers, Merril Lynch and Morgan Stanley - exist, an indication of the depth of the crisis. Faced with a fierce run on it's dwindling reserves and it's stock plummeting, Bears Stearns was forced to sell itself off to J P Morgan Chase (one of the largest commercial banks in the US) on March 16, 2008. The next three months could be best described in terms that the police often use in India: tense but under control. On July 01, the next piece of bad news emerged and shattered the uneasy calm: Country Wide Financials, the largest mortgage seller in the US, collapsed and was acquired by Bank of America (one of the largest commercial banks in the US). Following closely on the heels of this event, IndyMac bank failed - the second largest bank failure in US history - and was taken over by the Federal Deposit Insurance Corporation (FDIC), one of the institutions responsible for monitoring the health of the banking system in the US. IndyMac was, unsurprisingly perhaps, part of the Country Wide financial family.

Things started speeding up in September. On September 08, Freddie Mac and Fannie Mae, the two government supported enterprises (GSE) operating in the mortgage market was nationalized, with assets of the two entities totalling to more than $ 5 trillion. On September 15 another of the five famed investment banks, Lehmann Brothers, filed for bankruptcy; Lehmann's assets were a little over $ 600 billion and this made it's bankruptcy filing the largest in US history. Next day, the Fed stepped in with a $ 85 billion loan to prevent American International Group (AIG), the largest insurance firm in the US from going under. These two events, Lehmann's bankruptcy filing and AIG's rescue, sent shock waves through the world financial system. The result was a rapid erosion of faith in the financial system leading to a veritable credit freeze: financial institutions stopped lending, to other financial institutions, to businesses and to consumers.

The next thirty six hours, from the morning of September 17 to the evening of September 18, accelerated the credit crisis to extremely dangerous proportions and convinced the US Treasury and the Federal Reserve that government intervention of unheard magnitudes (at least since the Great Depression) would be necessary to prevent total financial collapse. Ben Bernanke, the chairman of the Federal Reserve (the US Central Bank), was famously reported as saying, at one point during this 36 hours, that if the government did not save the (financial) markets now there might not be any financial markets in the future. So, what happened during those crucial 36 hours?

The crucial 36 hours

The first indication of a severe stress in the financial system was a shooting up of credit default swap (CDS) rates, especially on Morgan Stanley and Goldman Sachs (two of the famed five Wall Street investment banks) debt, during the early hours of September 17. Credit default swaps are insurance contracts that can protect bondholders against the possibility of default. For example if an investor has bought bonds worth $ 1 million issued by firm A, then the investor can also buy CDS - typically issued by financial institutions like large commercial banks, investment banks or insurance companies - to protect herself against a possible loss resulting from firm A defaulting on it's bonds; the premium that the investor pays for the CDS is called the "rate" or "spread" and it is typically around 2% of the amount insured (the "notional value"). So, in the case of this example, the investor would pay $ 20,000 to buy CDS and if firm A were to go under, then the "counterparty" to the CDS contract (i.e., the financial institution that issued the CDS to the investor) would step in to pay the investor $ 1 million and the interest on that amount.

CDS rates (i.e., the premiums that are paid on the insurance contracts) are, thus, an indication of the market's belief about the possibility of default of some institutions; CDS rates on bonds issued by firms are

typically low when the market thinks the probability of default of those firms are low and high when the market thinks the probability of default are high. Thus, on the morning of September 17, when CDS rates went through the roof, this provided evidence of severe loss of faith in the financial system.

When investors lose faith in the financial instruments issued by private parties, they turn back to those issued by the government and that is what happened when CDS rates multiplied by close to a factor of five. Investors let go of private financial instruments like hot bricks and rushed into US government securities, a phenomenon often described as "flight to safety". The US government, i.e., the US Treasury department, issues three primary kinds of securities: T-bills, T-notes and T-bonds (where the "T" stands for Treasury), where bills mature in less than a year, notes mature between one and ten years and bonds are of longer maturities than a decade. When investors lost faith in the private financial system, they rushed in to US T-bills, the short-run heavily-traded ultra-safe US government securities. This huge rush into T-bills pushed up the price of T-bills and drove the yield (i.e., interest rate) on T-bills down. At one point in time, during this 36 hour period, the yield on T-bills was pushed down all the way to zero (the lowest it can ever go to) implying that investors were willing to hold T-bills even though the nominal return was zero and real returns were negative (because the inflation rate was positive).

As private investors were madly rushing into the safety of US T-bills, another important event was unfolding in the mutual funds market. Money market mutual funds (MMMF) are financial institutions that have become popular over the last three decades, especially in the US. They typically work as follows: investors put their money in MMMF's by purchasing shares in the MMMF's stock; thus the MMMF becomes a mechanism for pooling huge amounts of money and then using those large sums for investing in a very diversified portfolio of financial assets, thereby making the investments extremely safe. Thus MMMF's were, till September 17, thought to be as safe as a deposit account in a commercial bank, and the added advantage was that the money invested in MMMF shares would give a positive rate of return as opposed to a deposit account which is usually non-interest bearing. On September 17, one of the oldest and largest MMMF's, Reserve Primary Fund, "broke the buck", i.e., it made losses on it's investments such that it could not guarantee a positive return to it's shareholders. Every dollar invested in Reserve Primary was now, by it's own admission, worth less than a dollar. This was an unheard of event and as news of Reserve Primary Fund's losses spread, investors started pulling money out of MMMFs.

This had a very negative consequence for the real economy because of the serious involvement of MMMFs in the commercial paper (CP) market. Businesses typically need to constantly borrow short-term funds to keep their operations going; these borrowed funds go towards funding payroll, paying suppliers, maintaining inventory, etc. Firms, at least the big ones, usually borrow short-term funds in the US by issuing commercial paper (which is essentially a bond with a short maturity of about a week or a month). Who buys commercial papers? The most active institutional investors in the CP market are the MMMFs; some of the largest chunks of commercial papers are bought by the MMMFs. So when the MMMFs faced an increasing spate of withdrawal, in the wake of Reserve Primary Fund's breaking the buck, they stopped buying commercial paper. This, essentially, meant that the CP market ground to a halt. Thus businesses were no longer able to borrow the short-term funds that they need to keep operating. The economy, by all means, shut down.

Adding to and going hand-in-hand with these processes were the growing problems in the interbank (lending) market. Commercial banks typically lend and borrow banking system reserves (roughly the sum of currency in the banks' vaults and the amount they hold in their account with the Central Bank) among themselves for very short periods, usually overnight periods. The interbank lending market that is most closely watched is the London interbank market and the rate at which loans are made in this market is the London Inter Bank Offered Rate (LIBOR). The most important characteristic of loans in the interbank market is that they are unsecured, i.e., they are not backed by collateral. Thus, a bank can get a loan in the interbank market only if other banks consider it financially sound; thus when the LIBOR jumps up suddenly it provides evidence that the largest and the best banks in the world have lost faith on each other. On September 17, the LIBOR shot up giving indication of increasing strain in the interbank market.

It was these sets of events - CDS rates shooting up, closing down of the CP market, increasing strain in the interbank market - that spooked the US administration and convinced them of the necessity of the most extensive government intervention in the financial markets since the Great Depression. These crucial sets of events were precipitated by the string of big financial failures that the US economy had witnessed over the first two weeks of September: the failure of Fannie and Freddie, the bankruptcy of Lehmann and the near-collapse of AIG. It was these failures that led to a rapid loss of faith in the financial system and heralded a full-blown credit crisis. And

why did Fannie and Freddie and Lehmann and AIG fail? All these financial institutions failed because at crucial points in time they could no longer raise money from the market to finance their assets, i.e., they could not borrow money or roll over their short-term debt; financing, for these institutions, had dried up. And why did financing dry up for these big and reputed financial institutions? Because each of these, in their own ways, were exposed to the subprime mortgage market and took huge losses when the subprime mortgage market started unravelling. As news of these failures spread, investors, fearing losses, became increasingly unwilling to lend money to these institutions.

III

The Need for Aggressive Fiscal Intervention

Before we move on to looking at the global economic crisis from a medium term perspective, i.e., before we take a look at the phenomenon of the house price bubble and associated speculation that created the grounds for the current credit crisis, it might not be amiss to focus on what can be done in the short-run to deal with the real consequences of the economic crisis: the deep and prolonged recession that the US economy will undoubtedly be pushed into. Real GDP figures released by the US Bureau of Economic Analysis (BEA) on October 30 indicated that the US economy was in the midst of a slowdown even before the financial storm hit the world economy in the middle of September. Real GDP in the US contracted at an annual rate of 0.3 percent for the third quarter (i.e., for the months of July, August and September), led by a sharp fall in consumer spending; businesses cut 240,000 jobs in October alone, the highest figure in 14 years. The financial storm, comprising a severe credit crisis and even a possible banking crisis, worsened the slowdown further. In such a scenario, fixing the financial mess, dealing with the credit freeze, averting a possible run on the commercial banking system and restoring confidence in the financial system will not be enough to prevent a plunge into a deep, prolonged and painful recession; addressing the credit crisis is necessary but not sufficient to deal with the grave crisis in the real sector. A direct and aggressive boost to aggregate demand is the only way to prevent the current recession from becoming a depression. Why is that so?

In any capitalist economy, such as the US economy, the level of aggregate economic activity and employment is determined, in the short run, by the level of aggregate demand, and fluctuations in employment and output are accordingly determined by fluctuations of aggregate demand. Aggregate demand is defined as the sum total of all expenditures on goods and services produced in the economy. Macroeconomists divide total expenditure that make up aggregate demand into four categories: consumption expenditure, investment expenditure, government expenditure and net export expenditure. Consumption expenditure is the total spending by households on durable and non-durable goods, and also services; investment expenditure is the total spending by firms on plant, equipment, machinery and inventories, and the residential investment expenditures by households; government expenditure includes the total spending by local, state and federal government agencies on goods and services (excluding transfer payments); and net export expenditure is the net amount that foreigners spend on buying goods and services produced in the domestic economy.

BEA figures released for the third quarter show that every component of aggregate demand emanating from the private sector of the US (or foreign) economy either declined or slowed down when compared to the second quarter. In real terms, consumption expenditure decreased by 3.1 percent, the steepest decline since 1980 when the US economy was in the grip of a severe recession; during the previous recession in 2001, consumption expenditures had not even declined. Investment expenditures, other than those devoted to maintaining inventories, have also declined. Real nonresidential fixed investment expenditures decreased 1.0 percent in the third quarter, in contrast to an increase of 2.5 percent in the second. Expenditures on nonresidential structures increased by 7.9 percent, compared with a much higher increase of 18.5 percent in the last quarter; expenditures on equipment and software decreased 5.5 percent. Real residential fixed investment decreased 19.1 percent, compared with a decrease of 13.3 percent in the second quarter. Demand emanating from the external sector has a similar story to tell: even though exports registered a positive growth, the growth had slowed down considerably falling from 12.3 to 5.9 percent.

This is hardly surprising. With credit drying up, home equity vanishing and layoffs increasing, working-class households cannot be expected to increase their expenditures on the purchase of goods and services; a continued decline in the stock markets, coupled with increasing volatility will make matters worse. A recent survey in the US showed that consumer confidence was at it's lowest value in 40 years, and so it is almost certain that consumption expenditure will not rise in the foreseeable future. Neither will export expenditures rise to shore up aggregate demand because most of the economies in the world are either already into a recession or are rapidly slowing down. Nor can firms be expected to increase their

expenditures on plant and machinery and equipment. And the problem here is more than a credit freeze: even if the credit markets were to ease due to government intervention, which it is adamantly refusing to do, firms might not be willing to expand their operations because they face sagging demand. Capitalist firms produce to make profits; if they expect markets to be down and demand to fall, they will cut back and not increase their expenditures even if the cost of financing goes down.

That leaves us with government expenditure as the only source for increasing aggregate demand. In the midst of possibly the worst economic crisis since the Great Depression, the US government needs to aggressively step up it's expenditure on goods and services; since private expenditures, either of firms or of households, cannot be expected to increase in the short-term, aggressive fiscal intervention seems to be the only way the US government can prevent the economy from sliding into a decade long L-shaped recession that was Japan's fate in the 1990s. Moreover, such expenditures are warranted even from a long-term perspective of economic growth. Rebuilding the crumbling public infrastructure like roads and bridges, improving and widening the ambit of the public transport systems in US cities, jump-starting the movement towards green technologies, making health care available to all working-class Americans, increasing the unemployment benefit substantially, investing in the educational infrastructure makes both short-term and long-term sense. It will help boost aggregate demand in the short run and prevent a slide into a prolonged recession, and in the long run it will build the physical and human capital to help take the US economy into a higher growth trajectory.

Two alternatives to boost the economy, which are often brought up in this context, also seem to have lost their efficacy: tax breaks and monetary policy. Tax breaks have already been tried out and does not seem to have worked; reeling under mountains of debt, the tax break (or refund) cheque is often used by households not for making new purchases but for reducing the outstanding debt. The second alternative, monetary policy action, is also rapidly reaching the point where it will become totally ineffective. For it is almost certain now that the US economy is already stuck in what John Maynard Keynes long ago called a liquidity trap, a situation where the Central Bank can no longer boost aggregate demand by reducing interest rates. The Fed has already reduced the target federal funds rate to 1 percent and reducing it further to 0 percent, the lowest it can go, will possibly not help. Even if confidence in the financial system is restored and nominal interest rates lowered, this might not increase borrowing by firms because of their bleak forecast of falling demand for the goods they produce. Monetary policy has reached it's limits; the only option to ward off a severe recession and decrease the pain on the working class seems to be aggressive fiscal intervention in terms of direct expenditure on goods and services by the US government.

IV

The Medium Term Story

The medium term story of the evolving financial crisis begins at the end of the last century. With the bursting of the dot-com bubble at the end of the 1990s, possibilities of a long recession hovered on the horizon. The Federal Reserve, the Central Bank of the US, moved in with the tools of monetary policy to ease the slowdown. The target for the federal funds rate, the key short-term interest rate that the Fed monitors as part of it's monetary policy tasks, was gradually lowered from over 6 percent per annum to a little below 2 percent within a span of about an year. Lowering interest rates to engineer a soft-landing for a slowing economy is a natural thing to do: reducing the cost of borrowing funds is a key way the Central Bank can affect the level of investment and consumption (especially of durable goods) expenditures and thereby boost the level of aggregate demand in a slowing capitalist economy. With finance in command, this normal and natural move had a perverse effect.

The effects of the falling federal funds rate gradually cascaded from the short-end to the longer end of the asset market, lowering interest rates on all kinds of contracts. One of the key long-term interest rates affected by this very sensible move of the Fed was the interest rate charged on various kinds of mortgage loans (loans to finance the purchase of homes). With mortgage interest rates falling, consumers not only started purchasing new homes with new mortgage loans but also refinancing their old mortgages. With the demand for mortgage loans increasing, and the increase sustained by a low-interest rate regime, house prices started picking up. Very soon, i.e., within a year or two, economists started noticing a bubble in house prices. There were several indicators of a house price bubble. For instance, the Case-Shiller house price index for 10 US cities - a commonly used price index for houses - increased rapidly since the early 2000s. Even more tellingly, the price-to-rental ratio of houses went through the roof. Between January 2000 and April 2006, the rental of an average house did not increase at all; during the same period, price of an average house increased by about 70 percent, sending the price-to-rental ratio on an upward spiral.

The fact that the price-to-rental ratio increased rapidly

gave a clear indication that a house price bubble was building up. People were, in other words, purchasing houses not because of the service provided by a house but because of speculative motives. A rough proxy for the value attributed by consumers to the service provided by a house is the rental rate; since this was not increasing, it meant that people were not valuing the real service provided by the house. But prices of houses were shooting up giving an indication of an increasing demand for houses (relative to supply). Most of this demand was clearly arising from speculative motives; many of the house purchases were for the purpose of selling them off at a later date to reap capital gains (i.e., the profit derived from the difference between the selling and the buying price of the asset). Thus, the rise in prices was not driven by "fundamentals" (i.e., increase in the intrinsic value of the service provided by houses) but largely by speculative motives of capital gains; that is precisely what leads to an asset price bubble and that is what happened.

Sub-prime Mortgage Market

A run of a couple of quarters of rising house prices was very soon incorporated into the expectation formation mechanisms of financial markets. As has been observed over and over again in history, rising asset prices very soon creates irrational expectations that prices will keep rising, rising certainly in the foreseeable future if not forever. Such periods of rapidly rising expectations, feeding primarily on itself, have been labelled as "manias" by economists studying periods of asset price boom-and-bust. Prominent examples of such economists are Charles P. Kindleberger and Hyman P. Minsky, coming, as they are, from very different political traditions. In the context of the early twenty-first century US economy, the unprecedented house price bubble created grounds for the emergence of predatory lending and the sub-prime mortgage market. The sub-prime mortgage market was the market for mortgage loans to less-than-creditworthy borrowers at very high interest rates that often came with hidden but onerous terms. (Useful material on predatory lending and the subprime mortgage market can be found here)

A financial innovation that indirectly helped the emerging sub-prime mortgage market and the practice of predatory lending was "securitization". Securitization, in the context of the mortgage market, meant pooling together hundreds and thousands of mortgage loans together and then selling bonds on that pool of mortgages. Investors buying those bonds - the mortgage backed bonds - received the income stream, both the principal and the interest, entailed by the mortgages as the mortgage borrowers serviced their debt. Securitization required that the entities, usually investment banks like Bear Stearns or Merril Lynch, that were issuing (i.e., selling) mortgage backed securities (the mortgage backed bonds or other kinds of assets backed by the mortgage pool) needed ownership of the pool of mortgages against which those mortgage backed securities were being issued. Thus, the entities that issued the mortgage backed securities went out and bought mortgage loans from the originators of the mortgages, i.e., those who sold the mortgage loan to the borrower, like Country Wide Financial (the largest mortgage seller in the US prior to the financial collapse).

The fact that mortgage loan originators had a market where they could sell off the mortgage loans they had originated created perverse incentives for the originators. Typically mortgage loan originators do a thorough screening to assess the financial background of applicants before making loans. With the emerging market for selling off mortgages, the effort at screening was reduced to zero. Things actually went even further. Since mortgages could be sold off at good prices to the investment banks, the mortgage loan originators had a incentive to start engaging in predatory lending, i.e., push mortgage loans on persons who they knew would not be able to sustain the payments entailed by the loan. Since the originator did not have to bear the risk of failure associated with non-payment of mortgage loans, they had no incentive to make prudent loans. All they had to do was to force some gullible working class person to agree to the sub-prime loan and then turn around and sell it off to some investment bank in Wall Street. Thus, the market for sub-prime mortgages proliferated, driven by rising demand coming from the Wall Street investment banks. And why were investment banks so eager to buy these sub-prime mortgages? To answer this question, let us look a little more closely at the process and results of "securitization".

Securitization

Securitization is the division, repackaging and dispersal of debt, earning huge fee income for the entity (usually an investment bank) that is undertaking this process. The process starts with some commercial or investment bank buying a swathe of mortgages, some prime, some sub-prime, from smaller financial institutions and pooling them together. Each mortgage, recall, entails a stream of future payments; so the pool of mortgages, entails some specific stream of future payments. Various categories or "tranches" of bonds, arranged according to their risk characteristics, are then issued against the pool of underlying mortgages, i.e., against the stream of future payments entailed by the pool of mortgages. Investors who buy these bonds (mortgage backed securities)

then have the claims on the mortgage payments coming through month after month after month; if some mortgage fails i.e., payments stop the lowest category (i.e., most risky) bondholder loses first, the losses travelling up the tier of the bonds.

Let us look at a specific example: Bear Stearns Alt-A Mortgage Pass-Through Certificate. This is how this mortgage backed security worked. Bear Stearns bought 2871 mortgages from different mortgage originators for a total of $1.3 billion; this mortgage pool had mortgages that had been originated in different parts of the US, each worth on average for $ 450,000. Bear Stearns then pooled these diverse mortgages and issued 37 different bonds against that pool of mortgages; these bonds were called the Alt-A Mortgage Pass-Through Certificates. Alt-A stands for a very specific kind of mortgage: a mortgage where the originator does not ask any questions about the financial situation of the borrower before making the loan. It is not even ascertained whether the person taking the loan has a stable employment or not! Two additional players come into the picture: credit rating agencies and insurance companies.

Since many investors had an idea that the mortgage backed bonds were risky investments, they required some "independent" rating agency like Standard & Poor's or Moody's to ascertain the riskiness associated with investing in those bonds. This is one of the typical functions of credit rating agencies: to ascertain the riskiness (i.e., risk of default) of bonds and assign a credit rating to it; credit ratings run from AAA/Aaa (least risky) to C/D (in default). There were two problems with the involvement of credit rating agencies in the whole securitization process. First, there was an acute shortage of reliable information about the mortgages in the underlying pool; recall how the mortgages in the pool had originated in very different geographical locations, had been offered to very different income categories of people. Most importantly, very little information was collected about the financial standing of the borrowers (especially in Alt-A mortgages). So, despite their best efforts, the credit rating agencies could not come up with realistic risk assessment of the bonds issued against the pool of mortgages. The second problem was even more serious: a conflict of interest. Who paid the fees to the credit rating agencies? The same investment banks that issued the mortgage backed bonds; thus, there was a real incentive for the rating agencies to underplay the risk and certify most of the bonds as "investment grade". That is more or less what happened, as we now know.

The other player in the securitization process was an insurance provider; since investment in mortgage backed securities (and other related assets) carried some risk investors wanted insurance against default. The instrument that was used to provide insurance for such transactions was the credit default swap (CDS), a derivative financial instrument. Suppose an investor bought bonds worth $1 million; then, to insure herself against the possibility of default she could buy CDS from some financial firm like AIG on those bonds. The insurance premium that she had to pay, called the CDS rate or spread, was typically in the range of 1-2 percent of the value of the bonds, $1 million in this case. She would thus pay $ 20,000 (if the CDS rate was 2 percent) and the CDS contract would protect her against default for the period of the validity of the contract (typically a few years). In the bonds were to go into default the firm that had issued the CDS would have to pay her the amount of her losses.

There were several problems with the CDS market. First, it was an over-the-counter (OTC) market and did not operate through an exchange; hence the possibility of monitoring or regulating this market were negligible. All the contracts were bilateral contracts and no one other than the two parties to the exchange could, in principle know the details of the contract. Second, unlike traditional insurance contracts, there were no reserve requirements. Thus, the financial entity selling the CDS was not required, by law, to hold any reserves against the CDS issued, unlike traditional insurance. So, if the CDS were to actually come due there was no guarantee that the firm that had issued the CDS would be in a situation to make good it's side of the contract. Third, the most bizarre aspect of the CDS market was that the investor buying the CDS was not required to hold the underlying assets.

This third aspect is truly incredible and led to a veritable explosion of speculation. Let us think about this for a minute. It meant that if I believed GM would fail three years down the line, an investor could buy $10 million worth of CDS on GM bonds by paying a fee of $200,000 (assuming a CDS rate of 2 percent); and this the investor could do even though she did not hold any GM bonds. If GM actually failed and her bet was correct she could make $10 million on an investment of $200,000, a phenomenal 49 fold return! One could never expect to make such return by actually holding the bonds, and so investors started making huge bets using the credit default swaps instead of investing in bonds and stocks. By the end of 2007, the CDS market had grown to about $ 55 trillion (about 4 times US gross domestic product).

But who bought the asset backed securities? Who bought the CDS? International investors of all kinds. Around the late 1990s, there was an enormous pool of footloose, speculative capital in the global financial arena. The East Asian crisis, the Russian crisis and

several other developing country crises freed up finance for investment in the US; and these investors wanted high returns even if that meant holding risky assets. That is precisely what the Wall Street investment banks were busy churning out: highly risky but high-return investments in the form of the asset backed securities and other more exotic assets. Hedge funds, pension funds, sovereign country funds and other large institutional investors lapped up the exotic assets which promised high returns.

But the whole edifice was built on very shaky foundations. This highly-leveraged investment game could remain profitable if either of two conditions were met: (a) mortgage payments kept coming in, and (b) house prices kept moving up. If mortgage payments stopped coming in, the property could be taken over and sold; hence sub-prime mortgages remained profitable investments even when the borrower was almost certain to default as long as house prices kept moving up. In the middle of 2006 house prices stopped rising and foreclosures started piling up; and then the whole process, the whole speculative game, started unravelling.

To the Short-term once again

With the medium term story more or less under our belts, let us return once more to the short term story and ask: why did Bear Stearns fail? Why did Lehman Brothers fail? Why was Fannie and and Freddie nationalized? What caused the near-collapse of AIG? Bear Stearns and Lehman Brothers went under for very similar reasons: they could not keep borrowing to finance their positions. Towards the end of it's life, Lehman was rolling over close to $ 100 billion a month to finance it's investments in real estate, stocks, asset-backed securities, bonds and other financial assets. When news of foreclosures started pouring in, investors became convinced that Lehman had big holes in it's balance sheet because of it's exposure to the sub-prime mortgage market. They refused to lend it money; thus it's cost of borrowing went up, it's stock prices plummeted and it's credit rating was dropped. With no other option left, it had to file for bankruptcy on September 15, 2008.

Fannie Mae and Freddie Mac were government supported entities (GSEs) that were created to help low-income homeowners get easy access to the mortgage market. They were meant to guarantee mortgages and was supposed to finance this operation by issuing it's own bonds which were implicitly backed by the US government. It is now clear that they did not stick to this mandate of theirs. Instead, they used the subsidized loans that they could get from the market (due to the implicit government guarantee) to invest in mortgage backed securities which were backed by pools of sub-prime mortgages. When the sub-prime mortgages started failing, these institutions started losing asset values and it became clear by mid-2007 that they could not sustain the mounting losses. At that point the government stepped in to explicitly guarantee their debt (because it was spread far and wide in the global financial system) which finally culminated in their nationalization.

AIG, the largest insurance company in the US, got into serious trouble because of the credit default swaps that it had written. Around mid-September, about $ 57 billion of insurance contracts that it had written, in the form of CDS, required it to raise serious money. The CDS were all written on bonds linked to pools of sub-prime mortgages and as the sub-prime market worsened, the possibilities of the CDS payouts coming due increased. Because of the possible losses that it could incur, credit rating agencies downgraded AIG. The way the CDS contracts were written, a credit downgrade required AIG to demonstrate that it was capable of making good on it's contracts; this required it to immediately "post collateral" to the tune of $ 15 billion; if it failed to post collateral, it would be considered bankrupt. Since it did not have that amount of reserves and could not borrow from a tightening credit market, it had to approach the Fed for funds.

Bubble bursts: Delevarging and Deflation

An aspect of the whole build-up that made the unravelling especially painful was the stupendous amount of leverage in the financial system. When the bubble was inflating every investment was so hugely profitable that investors borrowed heavily for investing. This was especially true of the investment banks whose leverage (i.e., ratio of debt to equity) was about 30:1 by 2007; thus, for every dollar of equity these institutions had borrowed 30 dollars. And a large part of the borrowing was at the shortest end of the market. This meant that the investment banks had to continuously borrow from the market (usually roll over their debt) in order to keep financing their assets and investments. This made the system extremely fragile because any serious problem would lead to painful deleveraging (i.e., forcibly reducing debt by various means often involving serious financial loss) and possibly even asset price deflation.

As foreclosures picked up speed, house prices started moving down. Defaults on mortgage payments and falling house prices meant that the mortgage backed securities started losing value. Often this meant that when lenders came knocking on the doors for their funds, assets had to be sold at short notice and at low prices to cover debt payments coming due. A rush to sell assets often led to a further fall in the value of assets, even those not linked to mortgage backed

securities, leading to worsening balance sheets in wider and wider circles. With bonds losing value and even facing default, the CDS contracts suddenly started coming into effect. Since CDS issuers like AIG had not held any reserves for such contingencies, they got into greater and greater difficulties as bonds insured by CDS contracts started failing.

Falling assets values meant that financial firms faced greater difficulty in borrowing from the market, partly because the value of assets that they could offer as collateral had already fallen. Falling collateral value often lead to increasing costs of borrowing in terms of higher interest rates. Difficulty is accessing funds gives another push to sell off assets to cover debt payments, taking the spiral one step down. Deleveraging and an asset price deflation and a string of failures and rescues really led the financial system, in mid-September 2008, to completely lose faith in itself; it is this severe loss of confidence that manifested itself in the credit freeze, the center piece of the short-term story.

V

The Long Term Story

The long term story, as I have already indicated, is a story about the rise and (possible) fall of neoliberalism. The Golden Age of Capitalism - the two and a half decades after the second World War - drew to a close by the late 1960s and global capitalism entered a period of structural crisis. The process of general capital accumulation is largely driven by current and expected trends of profitability of capital (measured by the rate of profit). When the rate of profit declines the process of capital accumulation slows down, heralding a period of crisis of capitalism. The rate of profit had peaked in the early-to-mid 1960s in both Europe and the USA; thereafter, the rate of profit continued to decline for the next decade and a half falling from a high of about 20 percent to a low of around 10 percent.

Structural Crisis of Capitalism

Why did the rate of profit fall during this period? The falling profit rate goes to the heart of capitalism and shows up deep contradictions in the process of economic growth and technical change that accompanies capitalist development. The technological dynamism of capitalism is driven by competition between capitals to increase profits by reducing the cost of production. When the share of wages in national income is high, there is a strong incentive for capitalists to reduce the amount of labour required for production. The Golden Age of Capitalism, being a period of regulated and welfare capitalism, had ensured high and rising real wages and therefore maintained a high and relatively constant share of wages in national income. That provided the incentive for adopting labour saving technical change, i.e., adopting new techniques of production that required less and less labour per unit of output. Labour saving technical change increased the productivity of labour.

But the increasing productivity of labour came at a cost: falling productivity of capital or the output-capital ratio (the ratio of output to capital). Labour saving technical change, which increased labour productivity, was only achieved by replacing labour with capital, i.e., more and more labour was replaced by more and more machines in the process of production. This is one of the characteristic features that we often observe with capitalist development: mechanization and the increasing capital intensity of production. The use of more and more machines that increased labour productivity meant that every unit of output now required less labour but more capital; thus labour productivity increased but capital productivity fell.

This is the pattern of technical change, whereby labour productivity increases but capital productivity falls, that accompanies capitalist development during significant periods of time. This is also the way Marx had described the pattern of technical change under capitalism in his discussion of the process of general capital accumulation in Volume 1 of Capital. That is why economists Gerard Dumenil and Dominique Levy has called this pattern "trajectories a la Marx", while Duncan Foley and Thomas Michl has called it Marx-biased technical change. But what has this pattern of technical change got to do with the falling rate of profit?

The rate of profit is defined as the ratio of profits to the total stock of capital and can be decomposed as follows:

rate of profit = (profit/capital) = (profit/output)*(output/capital)

Thus we see that the rate of profit is the product of two crucial ratios: (1) the share of profits in output, and (2) the productivity of capital. The share of profits in output, though high, had remained relatively stable through the Golden Age of Capitalism; this is a typical pattern observed under capitalism (other than for the neoliberal period). The productivity of capital, on the other hand, fell because of Marx-biased technical change leading to a sharp fall in the rate of profit, and ushering in a period of crisis for capitalism. The sharp decline in the rate of profit meant a decline in the revenues accruing to all sectors of the capitalist class, especially the top fraction. The neoliberal counterrevolution, the sharp turn in economic and social policy around the mid-1970s, was the response of the upper fraction of the capitalist class to their

declining income and power (a more detailed development of this argument can be found in Dumenil and Levy, 2004).

Neoliberal Response as a Prelude to Crisis

The neoliberal turn largely managed to achieve what it had set out to. Profit rates started moving up and the revenue accruing to capital, especially the top fraction of capital associated with the financial sector, increased enormously. But it was a period of unmitigated disaster for the working class. Unemployment rates rose across the capitalist world, wages stopped growing (or slowed down considerably) in real terms, social welfare expenditures were gradually cut down, unions and other working class organizations were "busted"; in short, the social power and revenue accruing to the working class was severely restricted. It was a true counterrevolution which restored the power and privilege of the ruling class.

The two figures below demonstrate this in vivid terms. Between 1950 and 1973, real wages had increased at an annual compound rate of 2.61 percent, closely following the phenomenal growth of labour productivity which grew at an average annual compound rate of 2.70 percent. The next 25 years stand in stark contrast to this. Between 1974 and 1999, labour productivity grew at 1.62 percent per annum while real wages grew at only 0.92 percent per annum. Thus, even though labour productivity growth had slowed down significantly, it was still growing at close to twice rate at which real wages increased. This created a stupendous growth in profit incomes and created the source of finance that was to submerge the US working class in debt for the next four decades.

A crucial aspect of the neoliberal turn was the deregulation of sundry aspects of the economy, including, most importantly, the domain of operation of finance. The last great crisis of capital during the Great Depression had brought forth several important changes and new developments in the regulatory framework of capitalism. One by one, each of these laws relating to the operation of finance, both domestically and internationally, were whittled down or even outright overturned. Thus, the burgeoning profit income and the shredding of all regulation together created the supply of debt finance in the US economy. The demand for debt arose from a working class facing stagnant wage incomes but long used to growing consumption expenditures. The net result was the largest build-up of debt in the US economy since the Great Depression. During the beginning of the Great Depression total debt was about 300 percent of US GDP; in early 2008, total debt in the US economy was touching 350 percent of GDP. It was this huge debt build-up resulting from three decades of neoliberal economic policies that created a systemically fragile financial superstructure which imploded, leading to a credit freeze, when the housing bubble burst (I have borrowed parts of this argument from Wolf, 2008).

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U S Economy
Autobiography of a Successful Speculator

By: George Soros

One of the advantages of having been engaged in the financial markets for more than fifty years is that I have a personal memory of their evolution. In the course of my career I have seen them change out of all recognition. Arrangements that would be outlandish today were at one time accepted as natural or even unavoidable and vice versa. Financial instruments and financing techniques that are in widespread use today would have been inconceivable in earlier times. I remember the time when I was an arbitrage trader specialization in warrants and convertible bonds. I was dreaming of creating tradable warrants out of stocks, but of course that would not have been allowed by the regulators. I could not have imagined the range of synthetic instruments that are regularly traded today.

At the end of World War II, the financial industry - banks, brokers, other financial institutions-played a very different role in the economy than they do today. Banks and markets were strictly regulated. The total amount of credit outstanding in relation to the size of the economy was much less than it is today, and the amounts that could be borrowed against different types of collateral were also much smaller. Mortgages required at least 20 per cent down payment, and borrowings against stocks were subject to statutory margin requirements that restricted loans to 50 per cent or less of the value of the collateral. Auto loans, which required down payment, have been largely replace by leases, which do not There were no credit cards and very little unsecured credit. Financial institutions represented only a small percentage of the market capitalization of U.S. stocks. Very few financial stocks were listed on the New York Stock Exchange. Most banks were traded over the counter, and many of them traded only by appointment.

International financial transactions were subject to strict regulation by most countries, and there was very little international capital movement. The Bretton Woods Institutions were set up in order to facilitate international trade and to make up for the lack of international investment by the private sector. They were brought into existence by the United States in consultation with a British delegation led by John Maynard Keynes. The British proposed and the United States disposed. The shareholders of the Bretton Woods institutions were the governments of the developed world, but the United States retained veto rights.

Although the international financial system was officially on the gold standard, in effect the dollar served as the international currency. The price of gold was fixed in dollars. For a while the countries of the British Commonwealth remained tied to sterling, but as sterling kept depreciating, the sterling area gradually disintegrated. In the aftermath of the war there was an acute shortage of dollars, and the United States embarked on the Marshall Plan to facilitate the rebuilding of Europe. Gradually the dollar shortage was relieved, and with the formation of the European Common Market and the resurgence of Japan-to be imitated by the Asian tigers-the situation was reversed. Large-scale capital outflows, trade deficits, and the Vietnam War combined to bring the dollar under pressure. But control of the international financial system remained firmly in the hands of the developed countries, with the United States in a dominant position. When the convertibility of the dollar into gold was suspended on August 15, 1971, the dollar remained the main currency in which central banks kept their reserves.

I started my career as a trainee in a London merchant bank in 1953 or 1954, and learned arbitrage trading in stocks. Arbitrage means trying to take advantage of slight price differences between different markets. International trading at the time was mainly confined to oil and gold stocks, and it required the use of a special type of currency known as switch sterling, or premium dollars. Official exchange rates were fixed, but the currencies used for capital transactions fluctuated beyond the official band according to supply and demand.

I moved to the United States in 1956. after the formation of the European Common Market, there was a lively interest in investing in European securities, and I became actively involved as a trader, security analyst, and salesman. The business came to an abrupt end in 1963 when President John F. Kennedy introduced a so-called interest equalization tax, which effectively imposed a 15 per cent surcharge on the purchase of foreign securities abroad. Gradually I shifted my attention to U.S. securities, first as an analyst and then as a hedge fund manager. I belong to the first generation of hedge fund managers. There was not more than a handful of us when I started.

As an analyst I witnessed the gradual awakening of the banking industry. In 1972 I wrote a report entitled "The Case of Growth Banks". Banks at the time were considered the stodgiest of institutions. Managements had been traumatized by the failures of the 1930s, and safety was the paramount consideration, overshadowing profit or growth. The structure of the industry was practically frozen by regulation. Expansion across state lines was prohibited, and in some states even branch banking was outlawed. A dull business attracted dull people, and there was little movement or innovation in the industry. Bank stocks wee ignored by investors looking for capital gains.

In my report I argued that conditions were changing, but the changes were not recognized by investors. A new breed of bankers was emerging who had been educated in business schools and thought in terms of bottom-line profits. The spiritual centre of the new school of thinking was First National City Bank under the leadership of Walter Wriston, and people trained there were fanning out and occupying top spots at other banks. New kinds of financial instruments were being introduced, and some banks were beginning to utilize their capital more aggressively and putting together very creditable earnings performances. The better banks showed a return on equity in excess of 13 per cent. In any other industry, such a return on equity, combined with per-share earnings growth of better than 10 per cent, would have been rewarded by the shares selling at a decent premium over asset value, but bank shares were selling at little or no premium. Yet many banks had reached the point where they were pushing against the limits of what was considered prudent leverage by the standards of the time. If they wanted to continue growing they would need to raise additional equity capital. It was against this background that First National City hosted a dinner for security analysts--an unheard-of event in the banking industry.

That is what prompted me to publish my report in which I argued that bank stocks were about to come alive because managements had a good story to tell, and they had started telling it. Bank stocks did, in fact, have a good move in 1972, and I made about 50 per cent on the bouquet of growth bank stocks I had bought for my hedge fund.

Then came the first oil shock of 1973, and the money centre banks became involved in the recycling of petro-dollars. That is when the Euro-dollar market was born, and the great international ler..ding boom began. Most of the business was conducted abroad,

and United States banks formed holding companies to escape regulation at home. May new financial instruments and financing techniques were invented, and banking became a much more sophisticated business than it had been only a few years earlier. There was a veritable explosion of international credit between 1973 and 1979. It was the foundation of the worldwide inflationary boom of the 1970s. the United States did not participate in the boom. It suffered from stagflation - a combination of rising inflation and high unemployment.

In 1979 a second oil shock reinforced the inflationary pressures. In order to bring inflation under control, the Federal Reserve adopted the monetarist doctrine propounded by Milton Friedman. Instead of controlling short-term interest rates, as it had done hitherto, the Federal Reserve fixed targets for money supply and allowed the rate on federal funds to fluctuate freely. The Federal Reserve's new policy was introduced in October 1979, and interest rates were already at record levels when President Ronald Reagan took office.

President Reagan believed in supply-side economics and a strong military posture. In this first budget, he cut taxes and increased military spending simultaneously. Although a concerted effort was made to reduce domestic spending, the savings were not large enough to offset the other two items. The path of least resistance led to a large budget deficit.

Since the budget deficit had to be financed within the limits of strict money supply targets, interest rates rose to unprecedented heights. Instead of economic expansion, the conflict between fiscal and monetary policy brought on a severe recession. Unexpectedly high interest rates, combined with a recession in the United States, prompted Mexico to threaten defaulting on its international debt obligations in August 1982. that was the inception of the international banking crisis of the 1980s, which devastated Latin America and other developing economies.

The Federal Reserve responded to the crisis by relaxing its grip on the money supply. The budget deficit was just beginning to accelerate. With the brakes released, the economy took off, and the recovery was as vigorous as the recession had been severe. It was aided by a spending spree by both the household and the corporate sectors, and it was abetted by the banking system. Military spending was just gearing up; the household sector enjoyed rising real incomes; the corporate sector benefited from accelerated depreciation and other tax concessions. Banks were eager to lend because practically any new lending had the effect of improving the quality of their loan portfolios. The demand emanating from all these sources was so strong that interest rates, after an initial decline, stabilized at historically high levels. And eventually began to rise again. Foreign capital was attracted, partly by the high return on financial assets and partly by the confidence inspired by President Reagan. The dollar strengthened, and a strengthening currency combined with a positive interest rate differential made the move into the dollar irresistible. The strong dollar attracted imports, which helped to satisfy excess demand and to keep down the price level. A self-reinforcing process was set into motion in which a strong economy, a strong currency, a large budget deficit, and a large trade deficit mutually reinforced each other to produce non-inflationary growth. In The Alchemy of Finance I called this circular relationship Reagan's Imperial Circle because it financed a strong military posture by attracting both goods and capital from abroad. This made the circle benign at the centre and vicious at the periphery. This was the beginning of the United States' current account deficit and the emergence of the United States as consumer of last resort that continued, with many gyrations, to the present day.

The international banking crisis was contained by the active and imaginative intervention of the authorities. Providing liquidity to the banking system was not enough. The amounts owed by sovereign borrowers far exceeded the banks' own capital; if the countries in question had been allowed to go into default, the banking system would have become insolvent. The last time that happened was in 1932, and it caused the Great Depression. Because of that experience such an outcome was unacceptable. Accordingly, the central banks exceeded their traditional role and banded together to bail out the debtor countries. A precedent of sorts had been established in England in 1974, when the Bank of England decided to bail out eh so-called fringe banks that were outside its sphere of responsibility rather than to allow the clearing banks, from whom the fringe banks had borrowed heavily, to come under suspicion. But the crisis of 1982 was the first time that the strategy of bailing out the debtors was applied on an international scale.

The central banks did not have sufficient authority to execute such a strategy, and makeshift arrangements had to be made in which the governments of all the creditor countries participated and the International Monetary Fund (IMF) played a key role. Rescue packages were put together for one country after another. Typically, commercial banks extended their commitments, the international monetary institutions injected new cash, and the debtor countries agreed to austerity programmes designed to improve their balance of payments. In most cases, the commercial banks also had to come up with additional cash,

enabling the debtor countries to stay current on their interest payments. The rescue packages constituted a remarkable achievement in international cooperation. The participants included the IMF, the Bank of International Settlements, a number of governments and central banks, and a much larger number of commercial banks. In the case of Mexico, for instance, there were more than five hundred commercial banks involved.

I became a close student of the crisis and its resolution because I was fascinated by the systemic issues involved. I wrote a series of reports, distributed by Morgan Stanley, in which I analysed the makeshift solution developed by the international financial authorities. I called it the Collective System of Lending. The Collective as held together by the fear of insolvency. Accordingly the integrity of the debt had to be preserved at all costs. The left the debtor countries to fend for themselves; they were granted some concessions on the terms of debt service, but each concession added to their future obligations. The debtor countries accepted this treatment in order to maintain access to capital markets and to avoid seizure of assets and because of fear of the unknown. The austerity programmes did improve their trade balances, but in some cases the improvement could not keep pace with the accumulation of debt. Recognising the problem, banks were building bad debt reserves; but at the time I reviewed the situation in The Alchemy of Finance, no way had been found to pass these reserves on to the debtor countries without destroying the principle that held the Collective together. Eventually the problem was solved by the introduction of Brady bonds, but most of Latin America lost a decade of growth.

On previous occasions credit crises led to stricter regulations of the offending entities in order to prevent a recurrence. But under the influence of market fundamentalism, which became the dominant creed in the Reagan years, the international banking crisis led to the opposite outcome: Banks in the United States were granted greater freedom to make money. Practically all the restrictions that had been imposed on them in the Great Depression were gradually removed. They wee allowed to expand their branches, merge across state lines, and enter new lines, and enter new lines of business. The separation of investment banking and commercial banking faded until it disappeared altogether. Having been penalized by the Collective System of Lending, banks were anxious to avoid holding loans on their balance sheets; they preferred to package them and sell them off to investors who were not subject to supervision and persuasion by the regulatory authorities. Ever more sophisticated financial instruments were invented, and new ways to keep assets off balance sheets were found. That was when the super-bubble really took off.

The newly invented financial instruments and the newly introduced trading and financing techniques suffered from a fatal flaw. They were based on the assumption that financial markets tend towards equilibrium: They may temporarily deviate from it, but the deviations take the form of a random walk; eventually values revert to the established mean. Accordingly past experience was supposed to provide a reliable guide to the future. This assumption left out of account the impact of the new instruments and new techniques which changed the functioning of financial markets out of all recognition. I could vouch for that from personal experience: When I returned to the markets in the early 1990s after a few years' absence, I could not find my way around.

I date the inception of both globalization and the super-bubble to 1980s, when Ronald Reagan and Margaret Thatcher came to power. The period since then was punctuated by occasional breakdowns in particular market segments. The international lending spree of the 1970s turned into the international banking crisis in 1982. the excessive use of portfolio insurance turned a stock market downdraft into an unprecedented steep drop in October 1987. Portfolio insurance involved the use of knock-out options. Because they were used on a large scale they could not be exercised without causing a catastrophic discontinuity. Similar episodes occurred on a smaller scale in other markets; I witnessed one in the dollar-yen exchange rates. The slicing up of mortgages into tranches caused a mini crash in the "toxic waste" tranche in 1994, which claimed a few victims. The Russian default in the emerging market crisis of 1998 led to the insolvency of Long-Term Capital Management (LTCM), a very large hedge fund using very high leverage, which threatened the stability of the financial system. It prompted the Fed to lover interest rates and arranges a cooperative rescue of LTCM by its lenders. These incidents did not lead to any regulatory reforms; on the contrary, the ability of the system to withstand these stresses reaffirmed the prevailing market fundamentalist creed and led to further relaxation of the regulatory environment.

Then came the technology bubble that burst in 2000 and the terrorist attack of September 11, 2001. To prevent a recession, the Fed lowered the federal funds rate to 1 per cent and kept it there until June 2004. that engendered the housing bubble, in which financial innovations played a major role. With the spreading of risks, more risks could be taken. Unfortunately, the risks were passed on form those who were supposed to know them to others who were less

familiar with them. What is worse, the newly invented methods and instruments were so sophisticated that the regulatory authorities lost the ability to calculate the risks involved. They came to depend on the risk control methods developed by the institutions themselves. The latest international agreement on the capital adequacy requirements of banks - Basel 2 - allows the largest banks to rely on their own risk management systems. Something similar happened to the rating agencies who were supposed to evaluate the creditworthiness of the financial instruments. They came to rely on the calculations provided by the issuers of those instruments.

I find this the most shocking abdication of responsibility on the part of the regulators. If they could not calculate the risk, they should not have allowed the institutions under their supervision to undertake them. The risk models of the banks were based on the assumption that the system itself is stable. But, contrary to market fundamentalist beliefs, the stability of financial markets is not assured; it has to be actively maintained by the authorities. By relying on the risk calculations of the market participants, the regulators pulled up the anchor and unleashed a period of uncontrolled credit expansion. Specifically, value-at-risk (VAR) calculations are based on past experience. With unchecked credit expansions, the past became a poor guide to current conditions. VAR calculations allowed for two or three standard deviations. Higher standard deviations, which ought to have been extremely scarce, occurred with greater frequency. This ought to have been a warning signal, but it was largely ignored by regulators and participants alike. All they did was to introduce stress tests to measure how well they were prepared for the unexpected.

Similarly, the various synthetic mortgage securities were based on the assumption that the value of houses in the United States taken as a whole never declines; individual regions may fluctuate, but the market as a whole is stable. That is what made securities spreading the risk over various regions seem more secure than individual mortgages. That assumption ignored the possibility of a nationwide housing bubble of the magnitude that actually occurred.

The regulatory authorities ought to have known better. After all, they had to intervene from time to time, and they knew that their intervention engendered a moral hazard. They paid lip service to the moral hazard, but when the chips were down they came to the rescue of institutions that were too big to fail. They knew that their intervention introduced asymmetric incentives that favoured ever-increasing credit expansion, uet they were so carried away by the prevailing market fundamentalist mood and their own success that they came to believe that markets can self-regulate. That is how credit expansion came to reach unsustainable levels.

The right time to constrain credit expansion is during the expansionary phase. Central banks do respond to price and wage inflation but do not feed called upon to prevent asset price inflation. Alan Greenspan did inveigh against the "irrational exubereance" of the stock market in December 1996 but did not go beyond words and stopped talking about it when his words did not have the desired affect. Greenspan had a more profound understanding of the economic processes than most experts, and he knew how to use the manipulative function in expressing his views. I was impressed by his forward-looking, dynamic approach, which stood in sharp contrast to the static, rearview-mirror assessment of European central bankers. He can be faulted, however, for allowing his Ayn Rand-inspired political views to intrude into his conduct as Chairman of the Federal Reserve more than would have been appropriate. He supported the Bush tax cuts for the top 1 per cent of the population and argued that the budget deficit should be reduced by cutting social services and discretionary spending. And keeping federal funds at 1 per cent longer than necessary could have had something to do with the 2004 elections. Responsibility for the real estate bubble can be justly laid at his feet.

Ben Bernanke is more of a theoretician and does not have Greenspan's manipulative skills. He and the Bank of England's Mervyn King were acutely concerned with the moral hazard, and this had much to do with their belated response to the bursting of the housing bubble in 2007. the authorities consistently ignored or underestimated the abuses and excesses in the mortgage industry and their effect on the real economy. The Federal Reserve had the legal authority to regulate the mortgage industry, which it failed to exercise. The Treasury also remained totally passive during this period and became active only when the crisis was well advanced. It introduced new regulations for the mortgage industry only after the industry ground to a standstill, and it confined itself to encouraging voluntary cooperation among lenders to mitigate the damage. That approach had worked in the international banking crisis of the 1980s because central banks could wield direct influence over the commercial banks involved. But the current crisis is incomparably more complicated because the mortgages have been sliced up, repackaged, and resold, and voluntary cooperation among unknown participants is difficult if not impossible to arrange. The attempt to create a so-called super - SIVs (structured investment vehicle) to forestall the threat that SIVs would have to dump their assets was stillborn; and arrangements to provide relief to people

who face a sudden jump in interest payments as their teaser rates expire in the next eighteen months will have only very limited effect. Mortgage service companies are overwhelmed and have no financial incentive to arrange for voluntary adjustments. There are some 2.3 million people in that category, many of whom have been duped by unscrupulous lenders. Altogether, the housing crisis will have far-reaching social consequences. One cannot expect this administration to do much about it. It will fall to the next administration to deal with a dismal reality. By that time it will be clearer exactly how dismal it is.

I was watching the evolution of the housing bubble from afar because I was not actively engaged in managing my funds. After y partner who ran the fund left in 2001, I converted my hedge fund into a less aggressively managed vehicle and renamed it an "endowment fund" whose primary task was to manage the assets of my foundations. Most of the money was farmed out to outside managers. Nevertheless, I could clearly see that a super-bubble was developing, and it was bound to end badly. I was on record predicting it in a book published in 2006. And I was not alone. The investment community was sharply divided between old fogeys like me and a younger generation who knew how to use the new instruments and techniques and believed in them Of course, there were exceptions among them. One of them stood out: John Paulson, who bought insurance against the default of sub-prime mortgages, which returned a manifold profit on the premium he paid. I invited him to lunch to find out how he did it.

When the crisis erupted in August 2007, I considered the situation grave enough that I did not feed comfortable leaving the management of my fortune to others. I resumed control by establishing a "marco" trading account that gave the fund an overall posture overriding the positions managed by others. I believed that the developed world, particularly the United States, was heading for serius trouble, but there were powerful positive forces at work in other parts of the world notably China, India, and some of the oil - and raw material-producing countries. We had built up substantial investment positions in the stock markets of those countries. I wanted to protect these positions by establishing substantial short positions in the developed world. I could use only blunt instruments like tradable stock indexes and currencies because I lacked detailed knowledge. Even so, the strategy was reasonably successful. It was not without ups and downs. The market became extremely volatile, and it took a lot o nerve to hold on to the short positions.

Some Policy Recommendations

It would be premature to put forward firm policy recommendations for several reasons. First, I am too involved in the markets to give the matter serious consideration. The drama currently unfolding is all-absorbing, and I have a lot at stake. I shall have to distance myself from the market to be able to think in a more detached manner. Second, not much can be expected from the current administration. Major new initiatives will have to await the new president, and only a Democratic President can be expected to turn things around and lead the nation in a new direction. Third, the situation is very serious, and the new policy initiatives need to be thoroughly discussed. I shall outline my current thinking more as subjects for discussion than as firm conclusions.

Clearly an unleashed and unhinged financial industry is wreaking havoc with the economy. It needs to be reined in. Credit creation by its nature is a reflexive process. It needs to be regulated in order to prevent excesses. We much remember, however, that regulators are not only human but also bureaucratic. Going overboard with regulations could severely impede economic activity. A return to the conditions that prevailed after World War II would be a big mistake. Credit availability fosters not only productivity but also flexibility and innovation. Credit creation should not be put into a straitjacket. The world is full of uncertainty, and market can adjust to changing conditions much better than bureaucrats. At the same time, we much recognize that markets do not just passively adjust to changing circumstances but also actively contribute to shaping the course of events. They may create the instabilities and uncertainties that make their flexibility so valuable. This has to be taken into account in formulating macroeconomic policies. Markets should be given the greatest possible scope compatible with maintaining economic stability.

In large part the excesses in the financial markets are due to the regulators' failure to exercise proper control. Some of the newly introduced financial instruments and methods were based on false premises. They have shown themselves to be unsustainable, and therefore they will have to be abandoned. But others help to spread or hedge against risks and need to be preserved. The regulators need to gain a better understanding of the recent innovations, and they ought not to allow practices that they do not fully understand. The idea that risk management can be left to the participants was an aberration. There are systemic risks that need to be managed by the regulatory authorities. To be able to do so they must have adequate information. The participants, including hedge funds and sovereign wealth funds and other unregulated entities, must provide that information even if it is costly and cumbersome. The costs pale into insignificance when compared to the costs of a breakdown.

Moral hazard poses a thorny problem, but it can be resolved. Let's face it: When the financial system is endangered, the authorities must cave in. Whether they like it or not, institutions engaged in credit creation must accept the fact that they are being protected by the authorities. They must, therefore, pay a price for it. The authorities must exercise more vigilance and control during the expansionary phase. That will undoubtedly limit the profitability of the business. The people engaged in the business will not like it and will lobby against it, but credit creation has to be a regulated business. Regulators ought to be held accountable if they allow matters to get out of hand so that an institution has to be rescued. In recent years matters did get out of hand. The financial industry was allowed to bet far too profitable and far too big.

The most important lesson to be learned from the current crisis is that the monetary authorities have to be concerned not only with controlling the money supply but also with credit creation. Monetarism is a false doctrine. Money and credit do not go hand in hand. Monetary authorities have to be concerned not only with wage inflation but also with avoiding asset bubbles. Asset price gives them one too many tasks to perform. The objection would be valid if the task of the monetary authorities could be confined to applying certain rules mechanically. Their job is more complicated than that. They are engaged in a delicate game of managing expectations using all the tricks involved in the exercise of the manipulative function. That is an art, and it cannot be reduced to science. Alan Greenspan was a grand master of the manipulative function. Unfortunately he put his skills at the service of the wrong cause; he was too much of a market fundamentalist.

Both the housing bubble and the super-bubble have been characterized by the excessive use of leverage. This was supported by sophisticated risk management models that calculated known risks but ignored the uncertainties inherent in reflexivity. If they do nothing else, regulators must reassert control over the use of leverage. They used to exercise such control. Equities are still subject to margin requirements, although these have become largely meaningless because there are so many ways around them. Mortgage securities and other synthetic instruments were never brought under control because they were introduced during the market fundamentalist era. Controlling leverage will reduce both the size and the profitability of the financial industry, but that is what the public interest demands.

One specific measure that could help relieve the credit crisis is the establishment of a clearing house or exchange for credit default swaps. Forty-five trillion dollars worth of contracts are outstanding and those who hold the contracts do not know whether their counterparties have adequately protected themselves. If and when defaults occur some of the counterparties are likely to prove unable to fulfill their obligations. This prospect overhangs the market like a Damocles Sword that is bound to fall, but not yet. It must have played a role in the Fed's decision not to allow Bear Sterns to fail. There is much to be gained by establishing a clearing house or exchange with a sound capital structure and strict margin requirements to which all existing and future contracts would have to e submitted.

What is to be done about the mess created by the bursting of the housing bubble? The usual anti-cyclical monetary and fiscal policies are appropriate as far as they go, but for the reasons I have given, they will not go far enough. Additional measures are needed to contain the collapse in house prices and alleviate the pain connected with it. For both these reasons it is desirable to let as many people keep their homes as possible. This applies both to the holders of subprime mortgages and to the people whose mortgages exceed the value of their houses. They may be considered victims of the housing bubble deserving some relief. But giving them relief is tricky because mortgages derive their value from the fact that they can be enforced by foreclosure. In most other countries borrowers are personally liable, while in the United States lenders usually have no recourse other than foreclosure. On the other hand, foreclosures depress house prices and aggravate the slump. They are also costly to all parties involved and result in negative spillover effects. What can be done to balance these considerations? This is a subject to which I have given more detailed consideration than the other issues I have discussed so far, and I have also involved my foundation, the Open Society Institute. Here are my preliminary findings.

About 40 per cent of the 7 million subprime loans outstanding will default in the next two years. The defaults of option-adjustable-rate mortgages and other mortgages subject to rate reset will be of the same order of magnitude but over a somewhat longer period of time. This will maintain the downward pressure on house prices. Prices are likely to fall below the long-term trend unless arrested by government intervention.

The human suffering caused by the housing crisis will be enormous. There is significant evidence that senior citizens were targeted for some of the worst predatory practices and are disproportionately defaulting on their mortgages. Communities of colour are also disproportionately affected. Given that home

ownership is a key factor in increasing wealth and opportunity in the United States, upwardly mobile young professionals of colour will be particularly hard hit. They bought into the promise of the "ownership society," and their assets are concentrated in home ownership. Prince George's Country, Maryland, offers a prime example. It is one of the most prosperous predominantly black countries in the nation, yet it is experiencing the highest number of foreclosures in Maryland. Data for Maryland show that 54 per cent of African American homeowners have subprime loans, compared to 47 per cent for Hispanics and 18 per cent for Whites.

Foreclosures reduce the value of surrounding houses, pushing additional home owners to abandon their property because their mortgages exceed the values of their houses. Ultimately, concentrated foreclosures destabilize entire neighborhoods and have repercussions in other areas, such as employment, education, health, and child well-being. Avoiding foreclosure ought to be the primary focus of additional policy measures. The already enacted initiatives of the Bush administration do not amount to more than exercises in public relations. Once you apply all the limitations you are left with practically nothing.

Both systemic and individualized approaches are needed. As regards the need for systemic intervention, I believe that Representative Barney Frank is on the right track, although in order to gain bipartisan support he does not go far enough. He put forward two proposals that would strike the right balance between protecting the right to foreclosure and discouraging the exercise of that right - if they were adopted in the sequence that he proposes. First, he would modify the bankruptcy law so that a bankruptcy judge could rewrite mortgage loan terms on a principal residence. This would put pressure on the lenders to voluntarily modify such mortgages in order to avoid a compulsory modification of the mortgage, or a "cram down." The objection from the Republican side is that it would impinge on the rights of the lender and therefore make mortgages more expensive in the future. But the Frank proposal only applies to mortgages originated between January 2005 and June 2007. Moreover, the current bankruptcy law already allows modifications of mortgages on second homes, and it has not affected their cost appreciably.

Second, Frank would empower the Federal Housing Administration (FHA) to provide guarantees that would help refinance subprime borrowers into affordable mortgages. The holders of the original loan would be paid off from the proceeds of a new FHA-insured loan at no more than 85 per cent of the current appraised value of the house. To compensate the FHA for providing guarantees, the FHA would retain a second lien on the property. When the borrower sells the home or refinances the loan, the borrower will pay from any profit of the higher of (1) an ongoing exit fee equal to 3 per cent of the original FHA loan balance; or (2) a declining percentage of any profits (e.g., from 100 per cent in year one to 20 per cent in year five and 0 per cent thereafter). After year five, only the 3 per cent exit fee will apply.

Both the strength and the weakness of this proposal is that it is voluntary. On the positive side, it does not violate the right to foreclosure. On the negative side, it applies only to a rather narrow segment of troubled mortgages. It is confined to borrowers whose income is at least two-and-a-half times their debt service costs. At the same time, the mortgage holders must be willing to accept 85 per cent of the current market value as payment in full without participating in any potential future upside in the home value. Frank's FHA proposal may well pass into law under the Bush Administration but it is unlikely to have much impact on the housing crisis. It will have to be substantially enlarged before it makes a meaningful difference. The bankruptcy modification, by contrast, would be meaningful, but it is opposed by the Bush administrati0n.

According to the mortgage industry, there are a number of legal and practical impediments that prevent loan servicers from modifying subprime loans facing delinquency and default. Servicers argue that securitization of mortgages makes it difficult to track individual loans and that "pooling and servicing agreements" substantially limit their discretion to alter loan terms. But the main impediment is "tranche warfare". Different tranches have competing interests in a given loan - one tranche may have a priority claim to the principal, another to the interest. Servicers resist rewriting mortgages because one tranche inevitable will take a deeper hit than others, and servicers are accountable to all tranches simultaneously.

There is a growing consensus, however, that pooling and servicing agreements allow greater flexibility than previously acknowledged. Notwithstanding the problems of securitizations, Moody's confirms that the rate of loan modifications is on the rise, but it still accounted for only 3.5 per cent of the loans that reset in 2007. More attention should be devoted to quantifying and documenting the benefits of loan modifications in order to persuade lenders to put additional pressure on their servicers to engage in workouts.

Unfortunately, however, even with sweeping reforms, many homeowners will be unable to afford to stay in their homes. Local governments will need to come to

terms with the fact that a significant share of homeowners will lose their homes. And because the most unscrupulous lending was concentrated in communities of colour, which are the most vulnerable financially, local governments face the daunting prospect of huge inventories of distressed properties being dumped on the market in precisely those neighbourhoods least equipped to absorb the shock. The trick here will be to ensure that those properties do not fall vacant or into the hands of absentee owners, but rather are quickly transferred to responsible buyers who occupy and maintain their homes.

Helping local communities will be a fertile field for private philanthropy. Matching funds from the federal and state governments could greatly increase its scope and impact. My foundation is sponsoring local initiatives in New York City and Maryland.

In New York City, we have initiated the Center for New York City Neighbourhoods with funding from New York City government, private philanthropy, and the lending industry. It will increase and coordinate foreclosure preventin advocacy, including counseling and referral services, legal assistance, loan remediation, and preventive outreach and education. Its primary mission is to keep borrowers in their homes. For those who are unable to stay in their homes, it will support the efficient transfer of properties to responsible homeowners or non-profit organizations to ensure neighbourhood stability. We are hopeful that it will assist as many as eighteen thousand borrowers annually. The Centre for New York City Neighbourhoods will serve as an honest broker, facilitating communication among borrowers, direct service providrs, and the lending industry. Although New York City's housing market has not been hardest hit by the current crisis, I hope that local solutions piloted in New York will serve as a model for other communities.

Various efforts are underway in Maryland to assist homeowners in or near default on their mortgages. The Baltimore Homeownerhsip Preservation Coalition and a similar coalition in Prince George's Country offer homeowners in trouble a place they can turn to which has their best interests at heart. The limiting factor is the lack of well-trained counselors. We plan to support various training schemes, some of which will likely receive state support.

We are studying what else can be done.

(Courtesy: The New Paradigm for Financial Market: The Credit Crisis of 2008 and What It Means; by George Soros)

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Crisis, Bankers' Bailout, and Socialist Analysis/Strategy

By: Dave Hill

The current crisis of Capital and the current response

In the current juncture, the crisis of capitalism, as in the repeated crises of capital and overproduction and speculation predicted by Marx, capitalists have a big problem. Their profits, the value of the shares and part control of companies by Chief Executive Officers and other capitalist executives (late twentieth century capitalists), are plummeting. The rate of profit is falling, has fallen.

The political response by parties funded by Capital, such as the Democrats and Republicans in the USA, and Labour, Liberal and Conservative in the UK is not to blame the capitalist system, not even to blame the neoliberal form of capitalism (new brutalist public managerialism/ management methods, privatisation, businessification of education, for example, increasing gaps between rich and poor, between schools in well-off areas and schools in poor areas). They have criticised only two aspects of neoliberalism: what they now (and only now!) see as the over-extent of deregulation, and the (obscene) levels of pay and reward taken by 'the big bankers', by a few Chief Executive Officers (CEOs).

Not an end to Capitalism or even to Neoliberal Capitalism

Talk of an end to neoliberalism is premature, so is talk of an end to capitalism. Criticism in the mainstream capitalist media and mainstream capitalist political parties is only of the excesses of Capitalism, indeed, only the excesses of that form of capitalism- neoliberal capitalism- that has been dominant since the 1970s, the Thatcher-Reagan years- dominant in countries across the globe, and within the international capitalist organisations such as the World Bank, the International Finance Corporation, the World Trade Organisation.

Premature, too, is talk of a return to a new Keynesianism, a new era of public sector public works, together with (in revulsion at neoliberalism's- in fact- capitalism's- excesses) a new Puritanism in private affairs/ private industry.

The current intervention by governments across the globe to 'save banks' can be seen as 'socialism for the rich', a spreading of the pain and costs amongst all citizens/ taxpayers to bail out the banks and bankers.

Side by side with this bailing out of the banks (while retaining them as private- not nationalised institutions!) is the privatisation, and individualisation of pain- the pain that will be felt in wallets and homes and workplaces throughout the capitalist countries, both rich and poor. Already (November 2008) we see in Britain the Conservative Party changing its previous policy of matching Labour's spending plans for 2010 onwards into a rightward slide- saying that public services will have to suffer, to pay for the cost of the crisis. Capitalist governments throughout the world will, unless successfully contested by class war and action from below, make the workers and their/ our public services, pay for the crisis. So that, once again, the bankers can make their billions, extracted from the surplus value of the labour power of workers.

It is true that finance institutions need government intervention, in order to keep funding loans and mortgages, to prevent banks and finance capital repossessing people's homes. But under what conditions?

Marxists and left socialists need to lead and support calls and mobilisations for the nationalisation of the banks. In Britain, for example, people such as John McDonnell, the leader of the 'left' Labour MPs in Britain, and the LRC (Labour Representation Committee) and Marxist groups such as the Socialist Party and the International Socialist Group and the Socialist Workers Party call for banks to be taken into public ownership (with the SP calling for 'compensation only on the basis of proven need'), in other words for the nationalisation of finance to be complete and long-term.

But Capital and the parties it funds will, seek to ensure that Capital is resurgent, and that after what they see as this temporary 'blip' in capitalist profitability, it will once again confidently bestride the world, though with less of an obvious smirk on its face, and with less obvious flashing of riches. At least for the time being.

In times such as these, of economic crisis and of the inevitable retrenchment, it will be the poor that pays for the crisis, in fact, not just the poor, but the middle and lower strata of the working class.

Controlling the Workers

And who better to 'control' the workers, the workforce, to sell a deal – cuts in the actual wage (relative to inflation) and the social wage (cuts in the real value of benefits and of public welfare and social services)- but the former workers' parties such as the Labour Party, or, in the USA, the party with (as with labour in Britain) links to the trade union movement- the Democrats. So US Capital swung massively behind Obama in the US Presidential election, and it is likely that increasing sections of British Capital will swing behind Gordon Brown and what is still regarded by many as a workers' party, or at least, the more social democratic of the major parties on offer. Better to control the workers when the cuts do come. And to return to a slightly less flashy form of capitalism- more regulated, but still the privatising neoliberal managerialising, commodifying, neo-colonial and imperialistic capitalism.

Resistance

This is, as ever, subject to resistance and the balance of class forces (itself related to developing levels of class consciousness, political consciousness and political organisation and leadership). Resistance is possible, and will, inevitably grow. Demonstrations, strikes, anger, outrage at cuts, will increase, perhaps dramatically, in the coming period. To repeat, to be successful instead of inchoate, such anger and political activism needs to be focussed, and organised. In such circumstances, the forces of the Marxist Left in countries across the globe, need to put aside decades old enmities, doctrinal, organisation and strategic disputes. In Britain, for example, the Socialist Party, the Socialist Workers party, Respect, the Alliance for Workers Liberty, the Communist Party of Britain, other groups on the Marxist Left, together with socialists within the Labour Party, need to rapidly form a coherent organisation/ alliance and expose the current crisis as a crisis not just of neoliberalism, but of Capitalism itself. And to pose Socialist alternatives. Here, the new anti-capitalist party in France (under the leadership of Olivier Besancenot), coalescing formerly rival groups and individuals, is an outstanding example of a successful regrouping/ regroupement of the Marxist Left. And in Britain, the Convention of the Left could play a coalescing role?

Of course, regroupment by itself just organises current activists and supporters. Regroupment needs to be followed by, accompanied now! by recruitment. At this particular moment in the crisis of capital accumulation and the actual and potential for loosening the chains of ideology/ false consciousness promulgated by knowledge workers in the (witting or unwitting) service of Capital.

Implications for Education Policy of the Current Crisis

Within England there may well be some minor changes following from disenchantment with neoliberalism. Such changes, the changes in recent years promoting more creativity in the curriculum, reducing the burden of tests, have been argued for by unions and by the Socialist Teachers Association (STA) for years.

But changes to restore and go beyond a more democratically accountable, less brutalist, less divisive,

less test-driven, less punitive education system, are not yet on the cards. With campaigns and mass pressures they could become so.

But there is nothing inevitable about neoliberal education transmogrifying any time soon into liberal child friendly and/ or socialist education for equality. These need to be fought for, and will need to be part of a wider transformation of social and economic relations in society.

Which is why we can foresee an intensification of right-wing attacks on radical and socialist educators, on critical pedagogues, throughout the capitalist world.

The culture wars, between the ideologies/ belief systems of Marxism and Socialism on the one hand, and the various forms of pro-capitalist ideology: social democratic, liberal –progressive, neoconservative, neoliberal and racist/ Fascist ideologies on the other, will intensify.

Interest in Marxism is growing. More are seeing through the Emperors' clothes of pro-capitalist politicians, sand their sleight of hand support for Finance Capitalism and Capitalist exploitation of the labour power of workers.

Hence, in these current times, Marxist and radical educators are dangerous. Intimidation, dismissals, public denunciations (there are many cases globally, most recently in Australia and the USA) will increase.

It is a time for civic courage, for hope, for Marxist analysis, for solidarity, for organisation. A united Left could and should display all five.

(David Hil lis Professor of Education Policy, University of Northampton, UK)

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The Bailout Profiteers

By: Naomi Klein

On October 13th, when the U.S. Treasury Department announced the team of "seasoned financial veterans" that will be handling the $700 billion bailout of Wall Street, one name jumped out: Reuben Jeffery III, who was initially tapped to serve as chief investment officer for the massive new program.

On the surface, Jeffery looks like a classic Bush appointment. Like Treasury Secretary Henry Paulson, he's an alum of Goldman Sachs, having worked on Wall Street for 18 years. And as chairman of the Commodity Futures Trading Commission from 2005 to 2007, he proudly advocated "flexibility" in regulation — a laissez-faire approach that failed to rein in the high-risk trading at the heart of the meltdown.

Bankers watching bankers, regulators who don't believe in regulating — that's all standard fare for the Bush crew. What's most striking about Jeffery's résumé, however, is an item omitted when his new job was announced: He served as executive director of Paul Bremer's infamous Coalition Provisional Authority (CPA) in Baghdad, during the early days of the Iraq War. Part of his job was to hire civilian staff, which made him an integral part of the partisan machine that filled the Green Zone with Young Republicans, investment bankers and Dick Cheney interns. Qualifications weren't a big issue back then, because the staff's main function was to hand over stacks of taxpayer money to private contractors, who were the ones actually running the occupation. It was this nonstop cash conveyor belt that earned the Green Zone a reputation, in the words of one CPA official, as "a free-fraud zone." During Senate hearings last year, when Jeffery was asked what he had learned from his experience at the CPA, he said he thought that contracts should be handed out with more "speed and flexibility" — the same philosophy he cited back when he was in charge of regulating Wall Street traders.

The Bush Administration has since reversed the Jeffery appointment, perhaps thinking better of giving a CPA alum such a central role in the Wall Street bailout. Still, the original impulse underscores the many worrying parallels between the administration's approach to the financial crisis and its approach to the Iraq War. Under cover of an emergency, Treasury is rapidly turning into an economic Green Zone, overrun with private companies collecting lucrative contracts. Fittingly, one of the first to line up at the new trough was none other than the law firm of Bracewell & Giuliani — yes, that Giuliani. The firm's chairman, Patrick Oxford, could scarcely conceal his glee over the prospect of cashing in on the bailout. "This one," he told reporters, "is very, very big." At least four times bigger, in fact, than the post-9/11 homeland-security bubble, from which Giuliani and his various outfits have profited so extravagantly. Even bigger, potentially, than the price tag for the Iraq War itself.

In Iraq, the contractors were tasked with reconstructing the country from the mess made by U.S. missiles. After years of corruption born of no-bid contracts and paltry oversight, many Iraqis are still waiting for the lights to come back on. Today, a new team of contractors is lining up to reconstruct the U.S. economy-

reconstruct it from the mess made by the very banks, brokers and law firms that are now applying for contracts. And it's not at all clear that America can survive their assistance.

See if any of this sounds familiar: As soon as the bailout was announced, it became clear that Treasury officials would hire outsiders to perform their jobs for them — at a profit. Private companies wanting to help manage the bailout were given just two days to apply for massive, multiyear contracts. Since it was such a mad rush — after all, the entire economy was about to implode — there was no time for an open bidding process. Nor was there time to draft rigorous rules to make sure that those applying don't have serious conflicts of interest. Instead, applicants were asked to disclose their conflicts and to explain — and this is not a joke — their "philosophy in fulfilling your duty to the Treasury and the U.S. taxpayer in light of your proprietary interests and those of other clients." In other words, an open invitation to bullshit about how much they love their country and how they can be trusted to regulate themselves.

The first major contract to be awarded in the bailout was for legal advice — and the choice Treasury made was Halliburton-esque in its audacity. Six law firms were invited to bid, but four declined, either because they didn't want the contract or because they had too many conflicts of interest. Rep. Barney Frank, chairman of the House Financial Services Committee, said the fact that so many law firms chose not to bid "shows that the guidelines are sufficiently rigorous."

Or it may just show that the bidder who won the contract — Simpson Thacher & Bartlett — takes a more relaxed approach to conflicts than its colleagues. The law firm is a Wall Street heavy hitter, having brokered some of the biggest bank mergers in recent years. It also provided legal support to companies trading mortgage-backed securities — the "financial weapons of mass destruction," as Warren Buffett called them, that detonated the banking industry. More to the point, it was hired to provide legal services to the Treasury in its negotiations to spend $250 billion of the bailout money purchasing equity in America's banks. The first stage of the plan involves buying stakes in nine of the country's top banks. Incredibly, Simpson Thacher has represented seven of the nine: JPMorgan, Bank of New York Mellon, Bank of America, Citigroup, Morgan Stanley, Goldman Sachs and Merrill Lynch.

According to its contract, Simpson Thacher has agreed not to represent any of the banks "against the U.S." when they negotiate with Treasury for the equity money. However, the firm has retained the right to represent banks when they apply for other parts of the $700 billion bailout not covered by its contract. (It has promised to erect a "firewall" to stem the flow of "confidential information" to those clients.) The firm will also continue to work for the banks on a range of other lucrative deals — and that's where the problem lies. Take Lee Meyerson, Simpson Thacher's lead lawyer on the bailout negotiations, who is specifically named in the contract as "essential" to the project. As the company's hotshot attorney, Meyerson has personally represented three of the nine banks that were bailed out in the first round, in addition to many others that will surely apply for cash injections. One of the bailed-out banks is Bank of New York Mellon, whose $29 billion merger Meyerson helped negotiate. Mergers like that can bill in the millions. Is Simpson Thacher able to put aside its loyalties to its biggest clients and negotiate deals for the taxpayer that could exact real costs from those very clients?

It might be possible to set aside concerns about divided loyalties if it were clear that Simpson Thacher is helping Treasury to wrangle the best deals possible for U.S. taxpayers. But the firm's first test — the deal to give $125 billion to the nine big banks to ease the "credit crunch" that is crippling the economy — wasn't exactly reassuring. Secretary Paulson promised that the banks won't just "hoard" the money — they will quickly "deploy it" through the economy in the form of badly needed loans. There is just one hitch: Neither Paulson nor Simpson Thacher got that "deploy" part in writing — nor did they put in place any mechanism to require the banks to spend their taxpayer billions. Apparently, the part about lending the money to homeowners and small businesses was sort of implied.

"There is no obligation for banks to lend the money one way or the other," Jennifer Zuccarelli, a Treasury spokeswoman, tells Rolling Stone. "But the banks have the understanding" that the money is intended for loans. "We're not looking to control their operations."

Unfortunately, many of the banks appear to have no intention of wasting the money on loans. "At least for the next quarter, it's just going to be a cushion," said John Thain, the chief executive of Merrill Lynch. Gary Crittenden, chief financial officer of Citigroup, had an even better idea: He hinted that his company would use its share of the cash — $25 billion — to buy up competitors and swell even bigger. The handout, he told analysts, "does present the possibility of taking advantage of opportunities that might otherwise be closed to us."

And the folks at Morgan Stanley? They're planning to pay themselves $10.7 billion this year, much of it in bonuses — almost exactly the amount they are receiving in the first phase

of the bailout. "You can imagine the devilish grins on the faces of Morgan Stanley employees," writes Bloomberg columnist Jonathan Weil. "Not only did we, the taxpayers, save their company...we funded their 2008 bonus pool."

It didn't have to be this way. Five days before Paulson struck his deal with the banks, British Prime Minister Gordon Brown negotiated a similar bailout — only he extracted meaningful guarantees for taxpayers: voting rights at the banks, seats on their boards, 12 percent in annual dividend payments to the government, a suspension of dividend payments to shareholders, restrictions on executive bonuses, and a legal requirement that the banks lend money to homeowners and small businesses.

In sharp contrast, this is what U.S. taxpayers received: no controlling interest, no voting rights, no seats on the bank boards and just five percent in dividend payouts to the government, while shareholders continue to collect billions in dividends every quarter. What's more, golden parachutes and bonuses already promised by the banks will still be paid out to executives — all before taxpayers are paid back.

No wonder it took just one hour for Paulson to convince all nine CEOs to accept his offer — less than seven minutes per bank. Not even the firms' own lawyers could have drafted a sweeter deal.

The day after it met with the nation's top banks, Treasury announced that it had selected the firm that would receive the juiciest contract of all: that of "master custodian." The winning company will be to the bailout what Halliburton is to the military: the contractor of contractors. It will purchase toxic debts from Wall Street, service them and auction them off in the future — a so-called "end-to-end process." The contract is for a minimum of three years.

Seventy firms applied for the gig; the winner was Bank of New York Mellon. Describing the scope of the megacontract, bank president Gerald Hassell said, "It's the ultimate outsourcing — because the Federal Reserve and the Treasury do not have the mechanics to run the entire program, and we're essentially the general contractor across the entire program. It's going to cross our entire company."

This raises an interesting point: Has the Treasury partially nationalized the private banks, as we have been told? Or is it the other way around? Is it Treasury that has been partially privatized by Wall Street, its massive rescue plan now entirely in the hands of a private bank it is directly subsidizing?

Shortly after receiving the contract, Hassell told investors that his institution is now well-positioned to profit from the market meltdown. "There's a lot of new business that's going on even in this chaotic marketplace," he said, "and so some of those things have been very positive to us." Just how positive, we don't know, because Treasury has blacked out the 10 lines of the "master custodian" contract that reveal how much Bank of New York Mellon will be paid. Though Treasury says it will release the information eventually, the secrecy goes beyond anything the Bush administration attempted in Iraq. Even Halliburton's dodgy contracts came with price tags attached.

Still, when the terms of the contract do become public, they may turn out to be surprisingly modest. Goldman Sachs has apparently offered to fulfill at least one bailout contract for free. Altruism may not be their only motivation. The real money at stake in the bailout lies not in payment for the work but in how the work is done. Think about it: If you're the one selling your debts to the government, wouldn't you also want to help decide which debts are eligible and how much they're worth? "The financial firms with assets to sell are in many instances the same firms the Treasury will rely on to value and manage the assets it is buying," The New York Times observed. "That is an invitation for these firms to set the price too high or to indulge in other mischief at the taxpayers' expense."

Bank of New York Mellon has a bad record for mischief. It is embroiled in a $22.5 billion money-laundering lawsuit in Moscow and has been forced to pay out a $14 million settlement in a related case. Though the bank's "master custodian" contract with Treasury prohibits unethical conduct, the arrangement seems rife with opportunities for abuse. According to its most recent earnings report, Bank of New York Mellon holds $1.2 billion in subprime mortgage securities. That means that in addition to the $3 billion it will receive as part of the equity program, it will also be eligible to apply for taxpayer money from the program it is being paid to administer. Neither the bank nor Treasury would comment on this direct conflict of interest.

On the same day that he allocated the first $125 billion to the banks, Secretary Paulson announced the largest federal budget deficit in U.S. history. Buried in his statement was a preview of the next phase of the financial disaster. The deficit numbers, he declared, reinforce the need to "pursue policies that promote economic growth and fiscal responsibility, and address entitlement reform."

He was referring to Americans who feel entitled to receive Social Security in their old age and Medicaid when they are sick. Those programs, Paulson implied, might not be able to survive the budget crisis he is currently creating for the next administration.

This is why the stakes of the bailout are so high: Unless we get a good deal, there will be nothing left over after the banks are done feeding to pay for the meager services now provided in exchange for taxation, let alone for the more ambitious initiatives promised on the campaign trail. The spiraling cost of saving Wall Street from its bad bets is already being used as an excuse for why we can't solve our many other crises, from health care to climate change.

There is a better way to fix a broken financial system. Treasury's plan to buy up the toxic debts never made sense and should be immediately scrapped — a move that would also handily get rid of most of the crony contractors. As for purchasing equity in banks, the next round of deals — and there will be more — has to start from the premise that the banks are bankrupt and will therefore accept whatever terms we choose to impose, including real regulatory oversight. The possibilities of what could be done if a chunk of the banking system were genuinely under public control — from a moratorium on home foreclosures to mandatory investment in green community redevelopment — are limitless.

Because here is what George Bush and Henry Paulson are hoping we won't figure out: **When a society no longer has enough money to pay for its most pressing needs, there are worse things than discovering you own the banks.**

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The End of American Exceptionalism

By: Jim Miles

Before the war in Iraq started Robert Kagan wrote a wonderful little narcissistic view of the United States and its abilities to provide peace in a world of democratic capitalism. It climaxed in my favourite statement of hubris and jingoism that I have read in recent supposedly academic scholarly works.

The proof of the transcendent importance of the American experiment would be found not only in the continual perfection of American institutions at home but also in the spread of American influence in the world.

Beyond that statement, Kagan indicated that while the rest of the world may welcome, ridicule, or lament that belief, "it should not be doubted." Current events, if not the many contra-indicators from previous historical events, clearly demonstrate the patriotic presumptiveness in this expression of U.S. exceptionalism.

Book Review: The Limits of Power – The End of American Exceptionalism. By Andrew J. Bacevich. Metropolitan Books, Henry Holt & Company, New York, 2008

Five years later, with the "transcendence" of the United States clearly not in effect, and its institutions clearly demonstrating their lack of perfection, Andrew J. Bacevich's new work The Limits of Power provides a wonderful cerebral antidote to the unsubstantiated claims of U.S. greatness professed by Kagan.

Bacevich does not come up with an all-encompassing statement similar to Kagan's, but his summaries and conclusions provide a degree of succinctness to his supporting arguments.

His general theme is that "freedom" as espoused by the United States is from a need to expand and consume, an imperial ambition that uses the military to try and guarantee ongoing consumption by the U.S. public for the economic power of the elites. The introduction, "War Without Ends," begins with the word "freedom…not so much a word or even a value as an incantation, its very mention enough to stifle doubt and terminate all debate." A common thread throughout the presentation is the philosophy of Reinhold Niebuhr, beginning with the recognition that U.S. dreams of managing the world are "born of a peculiar combination of arrogance and narcissism."

What is needed, as seen by Bacevich/Niebuhr, are "realism and humility…each infused with a deeply felt Christian sensibility." Today these are "in short supply." A paradox is presented in that "centered on consumption and individual autonomy, the exercise of freedom is contributing to the gradual erosion of our national power." The only argument with that statement derives from the current market meltdown as anything but gradual. The U.S. economy, as a world power, appears to be rapidly diminishing.

Following the introduction are three hard hitting essays that outline the problems faced by the U.S. today. The first of these is "The Crisis of Profligacy" a well chosen title from the root word profligate, meaning licentious, dissolute, recklessly extravagant, all coming from the Latin root indicating to strike down or overthrow. Bacevich may well have used the word only in its more narrowly defined sense indicating the trait of spending extravagantly or also meaning excess in action and immoderate indulgence of bodily appetites, both of which are a propos for current U.S. society. The intent remains clear either way as he discusses "the ethic of self-gratification"

leading to "foreign policy implications of our present day penchant for consumption and self-indulgence [that] are almost entirely negative," to the extent that it "threatens the well-being of the United States."

The route to this profligacy was through imperial expansion, starting with the acquisition of the continental U.S. By the time of the Industrial Revolution "Americans came to count on an ever larger economic pie to anesthetize the unruly and ameliorate tensions related to class, race, religion, and ethnicity." After World War II "more power abroad meant greater abundance at home." After the Carter-Reagan transition, Reagan and his successors "wielded U.S. military power to ensure access to oil, hoping thereby to prolong the empire of consumption's lease on life." Later when the Middle East's resources became more important the Reaganites "encouraged the belief that military power could extend indefinitely America's profligate expenditure of energy…[relying] on military might to keep order in the Gulf and maintain the flow of oil."

Finally, Bush "committed the nation to a breathtakingly ambitious project of global domination [that] demanded oil wars." The result for the military was that "A generation of profligacy had produced strategic insolvency," and more, at the time of writing the essays, created a "nervous speculation about a coming economic collapse comparable in magnitude to the Great Depression." The end result, at least as of this writing, is "Americans have yet to realize that they have forfeited command of their own destiny," and "[squandered] American wealth and power, while putting freedom at risk."

This profligacy is accompanied by "The Political Crisis", recognized here as a Congress "which has willingly ceded authority to the executive branch," resulting in the chief attribute being "dysfunction." This is accomplished in part by "using (or devising) some sort of diabolical other" with the intent to "simplify, clarify, and remove ambiguity" in order to "mobilize, discipline, and squelch dissent." The ideology of national security "provides a continuing rationale for political arrangements that are a source of status, influence, and considerable wealth."

Again Bacevich follows the story from World War II through to today's main "prince of audacity" within the ideology, Paul Wolfowitz, in whose ideas "national security served as a sort of surrogate religion" and "assigned a central role to military power." His conclusions argue that "the ideology of national security, American exceptionalism in its most baleful form, poses an insurmountable obstacle to sound policy," the "Americans can no longer afford to underwrite a government that does not work," and finally "To attend any longer to this elite would be madness…They have forfeited any further claim to trust."

These are every powerful statements - argued not simply by some armchair academic, or more correctly by some neocon chicken hawk as is Robert Kagan (one of the author's of the Project for a New American Century) - but by a career military man who served in Vietnam and the Gulf War, who retired to teach with an emphasis on foreign policy.

Bacevich leaves "The Military Crisis" for last. His "one undeniable conclusion" is that "Estimates of U.S. military capabilities have turned out to be wildly overstated." He discusses the illusions and lessons of recent military endeavours arriving at "the imperative of the moment is to examine the possibility of devising a nonimperial foreign policy." Having already recognized Wolfowitz as the grand architect of pax americana, Bacevich renders unto Douglas Feith, undersecretary of defense for policy under Rumsfield, as the "stupidest….guy on the planet," for his success on pushing forward with the Iraq war.

Of course that description would rightly apply to all the Bush neocons, as the lesson from preventative war suggests that "to launch a war today to eliminate a danger that might pose a threat at some future date is just plain stupid." Relating the "Exercise of military power" back to the "crisis of profligacy…is to invite inevitable overextension, bankruptcy, and ruin." From all that is being seen with current events, Bacevich's words ring out truthfully.

In his conclusion, "The Limits of Power," Bacevich ties these ideas together in a single perspective. First, nuclear weapons should be abolished as "an urgent national security priority" (thus fully denying Wolfowitz' position of nuclear dominance), as they are "unusable." This becomes a way of "Transforming humankind's relationship to the environment." He reiterates that equation of freedom with consumption and self-actualization that evinces "little appetite for either risk or sacrifice", tying it together with climate change arising from this profligate consumption of fossil fuels and the need to develop alternative energy resources. The "transition to a post-fossil fuel economy promises to be a costly proposition."

Bacevich returns to Niebuhr to support his closing position on the U.S., "The desire to gain an immediate selfish advantage always imperils their ultimate interests. If they recognize this fact, they usually recognize it too late." Ultimately, if the U.S. continues its imperial pursuit of wealth and comfort at the expense of others, the "Americans appear determined to affirm Niebuhr's axiom of willful self-destruction."

The Limits of Power is a wonderful antidote to the poisonous jingoism and hubris supporting "American exceptionalism." The ending is rather negative (for the United States), but by recognizing the crisis for what it is and defining the need to change foreign policy and the domestic consumption that commands that foreign policy, Bacevich provides a clear view as to where the U.S. and the world should be moving.

By: R. Taggart Murphy

The economic and financial dangers to Asia of the crisis need not detain us long for they are obvious. The region's stock markets are caught in the global downdraft. Asia's financial institutions are just as closely linked as those in every other part of the world to Lehman Brothers, AIG, Merrill Lynch and their devil's spawn of credit default swaps and "toxic waste" assets. We have already seen bank runs in Hong Kong and widespread layoffs by some of the regions' leading financial institutions. We are likely to see more of these troubles in Asia before the crisis plays itself out.

The United States appears headed into a recession that may be as bad as anything the country has faced since the 1930s. That in itself will spell trouble for a region that directly or indirectly relies on the United States as the final engine of demand. Japan in October, 2008, for example, ran its first trade deficit since 1982, something that is widely attributed to falling demand from the U.S.

But while this is all generally understood and prudent business and financial leaders in the region are already battening down the proverbial hatches, there is more going on here than simply the shrinking of the region's most important external market. For what we are seeing strikes at the heart of the entire process by which the region transformed itself over the past 50 years.

Endless Flood

To be sure, Asia had little to do with the "sub-prime" mortgages, the slicing and dicing of rotten credits, the heads-I-win, tails-you-lose ethos on Wall Street that form the immediate causes of this catastrophe. But as Charles Kindleberger pointed out in his classic Manias, Panics, and Crashes, manias of the type that have just ended so spectacularly on Wall Street cannot occur in the absence of rapid credit creation. That credit creation in the present case stems directly from the ability of the United States to pawn off on the rest of the world an endless flood of dollar obligations, obligations that for a good forty years now have never been presented for redemption with anything other than more U.S. government paper. It has been so long now that the United States had to obtain the money to service its debts by the usual means – selling more goods and services abroad than are bought; borrowing in a currency controlled by the lender rather than the borrower – that its politicians no longer have any institutional memory of what it all implies: the hard trade-offs of falling living standards and forced savings.

Like an alcoholic's wife who furtively keeps her husband plied with booze while managing to avoid thinking about exactly what she is doing, Asia has long facilitated the U.S. addiction to drowning its problems in endless dollar cocktails. But the current crisis suggests that the days of cirrhosis of the American liver and delirium tremens are upon us. Without a clear grasp of the ways in which Asia's economic methods have facilitated American political pathologies, without a plan to replace Asia's reflexive reliance on exports to the United States with another economic driver, Asia too will be drawn into the economic and political maelstrom that now engulfs Washington.

Asia did not set out to become America's pusher; it happened through historical accident and the logic of the situation rather than any thought-through strategy. To see this, we have to go back to the circumstances of the late 1940s. The United States had emerged from the Second World War with something over half the intact production capacity of the entire planet. But Washington was haunted by two fears: that the end of the pumped-up demand of the war years would mean the return of the Great Depression. And that a militant, monolithic Communism would capitalize on the war's devastation to bring much of the world under its control. The so-called Iron Curtain had descended to divide Europe and Korea, Mao Zedong's Communist Party had driven the American-allied Guomindang out of mainland China, while Communist-led anti-colonialist insurgencies were emerging in French Indochina and British Malaya.

The U.S. economic response was two-fold. First, at home, the United States adopted the new-fangled tools of Keynesian demand management to keep the country from sliding back into Depression. Meanwhile, abroad, the United States through such measures as the Marshall Plan and aid to Occupied Japan, essentially offered to finance on very easy terms the transfer of production capacity to war-devastated nations. And then agreed to accept the exports manufactured thereby without reciprocal demands for imports of American products. The notion that places like Japan could ever pose a serious economic threat to American industry did not occur to anyone on either side of the Pacific. What Washington cared about was that Japan and Western Europe not follow China and Poland into what was seen then as Moscow's orbit.

Export-led Growth

But the Keynesian synthesis that so electrified

economists and policy makers of the time in the United States seemed to have little relevance to the challenges faced by an Asia emerging from colonialism and war. Keynes had addressed himself to the problems of a highly developed economy finding itself stuck in a trough of structural unemployment and idle production capacity; in 1946, Japan and Korea did not have production capacity to idle. Instead, there were two alternative models of development on offer. One was the Marxist-Leninist; the other went under the rubric of import substitution or dependency theory – i.e., that the goal of development ought to be the freeing of a country from dependence on foreign financing and imported capital equipment. Both called for state-directed capital accumulation and autarkic development, although the latter did allow for market mechanisms to function at the local level. Both boasted an extensive theoretical literature. In early postwar Asia, China would be the champion of the former, India of the latter.

Japan, however, adopted neither. With the United States providing the initial wherewithal to rebuild its economy (albeit at the price of aligning its foreign policy with Washington's and ensuring that leftists were kept away from the levers of power), Japan chose instead to engineer an economic structure that focused on the rapid accumulation of dollars so that it could buy the capital equipment it needed. This meant the deliberate channeling of scarce domestic savings into externally competitive export industries. It is here that we see the origins of the distinctive Asian model of export-led growth. The distinction between this and the import substitution model then being championed by India's Mahatma Gandhi and, subsequently, Jawaharlal Nehru may appear a semantic one in that both called for the development of domestic industry behind protectionist walls. But they differed crucially in their stance towards the existing global financial order. India sought to eliminate its dependence on that order; Japan to accumulate sufficient dollars in order to exploit it for its own domestic needs. Largely for geo-political reasons, the architect and designated care-taker of that order – the United States – was perfectly willing and even happy to see Japan use it to cement postwar recovery and join the ranks of the non-Communist developed nations.

I wrote above that Japan "chose" its postwar path of development, but this is not quite correct. It happened not, as in Beijing or New Delhi, through any deliberate choice of an overarching theoretical model, but because the pressures and opportunities of the time made it seem inevitable to Japan's decision makers. The priority of recovery from the war's devastation was so obvious that it required no political discussion to give it legitimacy. The war years had left Tokyo with an intact institutional apparatus that could be used to channel scarce financing into targeted industries – it was easy enough to redirect the flows from munitions makers to promising export industries. With the fortuitous (for Japan) outbreak of the Korean War, the United States suddenly began placing large orders for Japanese goods needed to equip its military. Thus through a process more akin to biological evolution than conscious political choice, Japan found itself in a niche that functioned well-nigh perfectly for the country in the economic ecology of the era.

The results exceeded anyone's expectations. Between 1955 when the final elements of the postwar Japanese system were put into place and 1969 when its growth began to alter the global economic ecology which had fostered it, Japan boasted the highest growth rates that had ever been recorded by any economy in human history. But the circumstances of its birth – its coming into being without any real debate on the matter or generally accepted theoretical foundation – help explain what is happening today.

Accumulating Dollar Reserves

The late 1960s provided the first evidence that things could not keep on going as they had without adjustment. The rigid international financial architecture of the time, labeled the Bretton Woods system for the small New Hampshire resort town where it had been hammered out in 1944, could not accommodate the emergence of Japan's export surpluses – joined to a lesser extent by those of West Germany – and their mirror images, the first substantial trade deficits run by the United States for a century or more. Attempts to rework the formal arrangements of the Bretton Woods system collapsed in the political chaos surrounding the Watergate scandals and the American defeat in Vietnam. The world economy limped through the rest of the 1970s until Paul Volcker was appointed Chairman of the Federal Reserve in 1979 with a mandate to do what it took to halt the inflation that threatened to destroy the dollar as a store of value. Japan's vote of confidence in Volcker's policies – snapping up U.S. dollar securities – permitted the rebuilding of the organizing principle of Bretton Woods: the dollar's central role in the international financial system. But instead of Bretton Wood's formal arrangements that required the United States to back the dollar by gold while other participants maintained fixed exchange rates with the dollar, the new system was predicated purely on the willingness and ability of the likes of Japan to continue to accumulate and hold stores of dollars.

Meanwhile, Japan's 25-year sprint from devastation

to the front ranks of the world's industrial powers provided an overwhelming example to the region. South Korea, Taiwan and Malaysia all pro-actively adopted export-led growth strategies with concomitant suppression of domestic demand, undervalued currencies, and savings channeled into the development of internationally competitive industries. With the coming to power in 1977 of Deng Xiaoping and Beijing's tacit adoption of the Japanese economic model, the region turned decisively away from autarkic development models. Vietnam would arrive at the party in the late 1980s, and in 2000 India would formally abandon Nehru's legacy of import substitution to join in the scramble to build industries for export.

But not only did most Asian countries emulate Japan in making the highest national priority the building of internationally competitive export industries, they followed Japan in accumulating reserves in dollars – a trend that accelerated after the crisis of a decade ago. Most countries in the region, whether they had suffered badly (Thailand; South Korea), or largely escaped the worst effects (Malaysia; China) resolved they would never again be in a position where emissaries from Washington – or anywhere else, for that matter – would be in a position to dictate their macroeconomic policies or how they ought to structure their banking systems. They redoubled their efforts to build impregnable fortresses of international reserves against the slings and arrows of future balance of payments crises.

That effectively meant accumulating reserves in U.S. dollars. Aggregate two-way trade and investment flows between Europe and Asia are not large enough to permit the Euro to circulate yet in sufficient quantities in the region to see the Euro substitute for the dollar as the region's reserve currency, even if the region's businesses were willing to switch from dollars to Euros as their primary cross-border settlements currency. As for the yen, neither Japan nor China for separate reasons want to see the yen supplant the dollar in the region. China is not prepared to cede that kind of economic leadership to Japan, while the wrenching changes that the emergence of the yen as a major international currency would pose to the Japanese economic and political order insure that Tokyo will move to bring that about only when there is no alternative. (I discuss the reluctance of Japan to see the yen as an international currency here.)

But when a country accumulates reserves in dollars, it is effectively leaving its export earnings inside the American banking system where they can be used, among other things, to finance the building of houses for people who do not earn enough to afford those houses. The result is 7 figure salaries for gamblers with other people's money and tax cuts enacted while spending soars on entitlements and wars of choice.

Export-led Growth Doomed

The latest surge of dollar holdings in Asia on top of a generation of dollar accumulation in countries such as Japan and Korea coincided with the coming to power of the most fiscally irresponsible administration in American history. Not only did Asia's soaring dollar holdings help the George W. Bush administration avoid the usual financial consequences in ripping open the sutures its predecessor had stitched up between America's taxes and government spending. They also facilitated a horrendous asset bubble in American housing while Alan Greenspan's Federal Reserve watched idly from the sidelines.

The era of American "deficits without tears," in the famous phrase of the French economist Jacques Rueff, has ended with the Panic of 2008. The core institutions of American finance are collapsing. The United States is still – and will remain for some time to come – the world's largest and most productive economy. But it can no longer act as the world's engine of demand, no matter how many dollars Asia throws at it. For while those dollars may be "owned" by Asian central banks and businesses, they reside inside a ruined financial system whose panicked participants will not lend to those who need credit to keep their businesses running. As the Japanese can explain from their own experience of the mid 1990s, you can pour all the money you want into tottering banks and brokers, but when they are paralyzed by fear and will do nothing but lend back to the government, it does little for your economy.

The days of export-led growth for Asia are over (at least exports outside the region – intra-regional trade is another matter provided importers in the region can be found to equal exporters – and that the final demand is in Asia; i.e., exports of parts and supplies from one Asian country to another for finished products headed for the U.S. market don't count). As the Koreans and Thais can easily testify given their own recent traumas, the United States cannot recover from the mess it is in without more savings – another way of saying less consumption. That in turn means the U.S. after 40 years of profligacy will have to export more than it imports. For this to happen, much of the production capacity that has been steadily transferred to Asia over the last fifty years will have to be repatriated back to the United States so that Americans will have enough factories again in which to go to work to pay off the debts that their politicians

and bankers so recklessly ran up. Otherwise, all those dollars Asia holds will quickly be worth very little. **What, after all, is a dollar other than a claim on the output of an American? The Americans will have to have the means to create that output if the dollar is to have value.**

Meanwhile, what of Asia? How is Asia going to wean itself from its dependence on the U.S. market? One lesson the world may finally learn from this crisis is that genuine, long-term prosperity comes not from continuously shoveling money at distant foreigners so they can keep buying your stuff. And certainly not from games playing and speculation by would-be plutocrats. But rather from a large, economically secure middle class – a middle class with the means to purchase the output of a nation's factories, farms, and service providers.

Here is where we see a connection between the meltdown of American finance and the political turmoil that has been wracking practically every country in the region. Each specific example has it own local causes and flavors: the struggle in Thailand over former Prime Minister Thaksin's buy-rural-votes-populism; the political insurrection led by Anwar Ibrahim in Malaysia against the entrenched UMNO elite; the seemingly out-of-proportion demonstrations in South Korea over beef imports; the palpable rage in China at the inability of the government to enforce safety standards in construction and food provision; the challenge posed by Japan's first serious, united opposition in 50 years to the Liberal Democratic Party's control of that country's formal political institutions.

But behind these varied struggles one can hear a common theme: a demand for accountable, responsible government that puts the interests of the middle class first. I wrote at the beginning of this piece that the political discussion necessary to restructure the region's economies carries with it all kinds of risks. We have been seeing those played out in the streets of Bangkok and Seoul or on-line behind the firewalls that Beijing builds in its attempts to contain and control discussion of China's future. These struggles threaten, among other things, the workings of essential economic machinery, as Thailand's tourist-related businesses can readily testify. The struggles provide a profound challenge to elites that are accustomed to effecting minor corrections behind closed cockpit doors to national trajectories that have long been taken for granted.

But the meltdown of American finance has closed the destination of an economy humming with industries for export. Whether Asia's economies have the political will and ability to chart a new course will determine how they ride out the present storm.

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Transforming the Global Economy: Solutions for a Sustainable World

By: Susan George

Philosophically speaking, the thing-in-itself, the isolated object whether it's an electron, a human cell, an organism, a single word —even a human being--makes sense only in the context of its relationships, its place in its physical, linguistic or social environment. Margaret Thatcher once famously said, "There is no such thing as society". She thus perfectly embodied the foundations of the neo-liberal ideological programme which should, ideally, prevent us from even thinking about ourselves and others in our natural and social context. We must be taught to believe that we are not citizens or members of a social body but discrete, individual consumers. We are entirely responsible for our own destinies and if we fall by the wayside for whatever reason—illness, job loss, accident, failure, whatever—it's our own fault. We should have foreseen the case and planned for it. We have no responsibility for other people either. Solidarity is a banished word. Nor are we accountable for the state of the planet—homo sapiens is the only important species and humans are isolated if not immune from natural, physical laws. That's the essence of the neo-liberal spirit: "You're on your own" as Barack Obama has been saying to Americans to encapsulate the philosophy of his opponents.

If you are well-schooled in neo-liberalism, you will never join a social movement, never engage in a struggle against an unjust action of the government, never contribute to an effort to protect the natural world because not only will you make a fool of yourself, not only will your effort fail, but even if successful it will lead eventually to oppression, even totalitarianism, as Thatcher's mentor Professor Friedrich von Hayek argued. And, as he also taught, economic freedom is superior to every other kind of freedom, whether political, religious or intellectual.

I believe to the contrary that our only hope lies in understanding everything we confront today as a link in an ever-more-complex chain, as an element in a system. The danger with this approach of course is to become lost and frustrated in the syndrome of "Everything is connected to everything". That's true, everything is connected to everything, but we still have an enormous task ahead in trying to identify the priority connections, to understand how they work together and what we can do to change them, because they definitely do need changing. I will argue that the present connections are dysfunctional, they have become perverse: they form a system that worsens the human condition and irrevocably damages the planet. But there is hope, because what has been constructed by humans can also be dismantled by them.

All this may sound rather vague so let's get down to specifics. To make matters more concrete, I'd like to talk now about the most obvious crises we face collectively today, why they are all linked and why the solutions to them must be linked as well.

The first of these crises is social—the crisis of mass poverty and growing inequality within individual countries and between the rich and poor countries. The second is the financial crisis that Wall Street, the City and the public authorities refused to see coming because they were living in bubble-land. It began with the subprime affair in the United States but has spread inexorably like a lava flow in the US and elsewhere, threatening to plunge the global economy into a prolonged period of stagnation as severe as the Great Depression. Every day while I was writing this lecture at home, a new financial institution went down the drain or on the block and the end is not yet in sight. The third crisis, most ominous of all, is that of climate change and species destruction. It is accelerating faster than most scientists, much less governments, thought possible, causing many to ask if we have not already entered the era of the runaway greenhouse effect.

Each of these crises—social, financial, environmental--is negatively linked to the others, they intensify each other with negative feedback; they lead to worst-case scenarios. Let us take just a few examples of these perverse interactions.

The poverty-inequality crisis is a good place to start. This crisis is well documented; no one seriously denies the numbers. The World Bank recently recognised that it had grossly underestimated—by about 400 million—the numbers of the very poor, and even then its figures stop at the year 2005 and don't include recent upheavals in food and energy costs that have swelled the ranks of the impoverished. Even more important, however, is the fact that for the first time in human history, there is no excuse for mass poverty and deprivation. Taking this assertion seriously already helps to point us towards a solution.

Most scholars and institutions concerned with such issues focus on poverty per se but I think it's more useful and enlightening to focus on wealth. It may not be obvious to everyone that the world is actually awash in money. Most of it is still in North America and Europe but the numbers of the seriously rich on other continents are catching up fast. Those who have the money know very well how to keep it and, with their hired help, the battalions of lawyers, accountants and lobbyists, they are busy salting away their profits in tax havens, finding loopholes and protected investments, lobbying fiercely in parliaments and ministries against regulations on banks and financial markets. As you can see, I began by talking about poverty but I am already touching on the links with the financial crisis.

How many of you knew that ten million people, according to the latest Merrill-Lynch World Wealth Report, together boast investable, liquid funds of more than $40 trillion? That's 40.000 billion or 40 followed by 12 zeroes. This wealth is above and beyond the value of their houses, cars, yachts, wine or art collections and so on and it is equivalent to about three times the GDP of either the United States or Europe. You might like another simple calculation. Assume that you have one billion dollars, which is the cut-off point for the latest Forbes magazine list of 1125 truly rich individuals in the world. If despite your billion you are such a dim-witted investor that you get only a five percent return on your fortune, you will still have to spend $137.000 every day of the year in sheer consumption or you will automatically become richer. My point is that cash is abundant and there's no shortage of available wealth.

We also know a great deal about inequality. The UN World Institute for Development Economic Research, WIDER, estimates total world household assets at about $125 trillion. This is about three times world GDP and unsurprisingly, the top two percent of the world captures more than half of that wealth. The top 10 percent, which certainly includes many of us here, hold 85 percent, while the bottom half of humanity is obliged to stumble along with barely 1 percent. All you need to be classed in the top half of humanity is a meagre $2200 in total assets—that includes your house, your land or items like your car or your refrigerator--hardly a princely sum. If all household assets were divided equally—impossible and probably not even desirable to achieve—everyone

on earth could have a share of $26.000. So again, money as such isn't the problem.

In all the countries where 90 percent of the world's population lives, inequalities have increased especially since the 1980s. At this point in the argument, the neo-liberals usually jump in to remind us that rising tides lifting all boats. They admit that inequalities have grown, but still argue that the poor are better off than they were. It seems almost rude to remind them in turn that falling tides have the opposite effect, they swamp and strand the more fragile boats and that is where the tide of the financial crisis is now taking us.

The real point, however, is not the absolute numbers but the fact that inequality makes the economy and also the natural environment worse for everyone, rich or poor. Two experienced academics, Tony Addison and Giovanni Andrea Cornia, put it this way: "Inequality has risen in many countries over the last two decades [and] little progress can be made in poverty reduction when inequality is high and rising....Contrary to earlier theories of development, high inequality tends to reduce economic growth and therefore poverty reduction through growth."

Although it's true that economic growth has reduced poverty, particularly in China, one must also ask "At what cost?" China has now overtaken the United States in greenhouse gas emissions and frighteningly has hardly even begun its transition to the automobile society. China also requires at least 10 times as much energy as the more mature industrial societies to produce a unit of GDP.

Growth certainly isn't the answer ecologically, but even economically it fails the test because the benefits accrue almost entirely to the top of society. That is Cornia and Addison's main point.

We have also learned in the past few months that it is entirely possible to push tens of millions of poor people off the ledge where they had just gained a foothold and send them back into the depths of poverty. Food riots, most of them urban, in at least thirty different countries have revealed another scary new phenomenon: the worldwide food crisis. Until now, food shortages and famines tended to be local, but so many societies have accepted neo-liberal trade mantras and become dependent on world markets for their basic daily staples that today a sudden spurt in prices is felt from Haiti to Egypt to Bangladesh.

The neo-liberal institutions like the World Bank, the WTO and the European Commission continue to pretend that poverty reduction will result from more growth and more trade. They fail to mention that both growth and trade will reinforce the environmental crisis. The food and energy crises have in turn strong links to the financial crisis, since speculation has been an important factor in both. Food and energy are also intimately linked to the climate crisis as one can see instantly when one thinks of carbon-loaded fossil fuels or of agro-fuels taking vast amounts of land away from food production.

At this point in the discussion, especially when one is speaking to concerned, engaged, decent people like those likely to be found at a Schumacher lecture, someone will raise two highly pertinent questions. The first is this: " Isn't there a point where people with huge fortunes say 'enough is enough' and start sharing?" Some do—Bill Gates and Warren Buffet are oft- cited examples. But as a class, I'm sorry to say that the answer is no. We know a lot about poverty lines but there is no such thing as a wealth line and the word " enough " is not part of the vocabulary of this class. You needn't believe me. Listen to the expert who said "All for ourselves and nothing for other people seems in every age of the world to have been the vile maxim of the masters of mankind." That was not Karl Marx but Adam Smith, in his classic 1776 treatise on capitalism, the Wealth of Nations. Little has changed since then.

The second question is "But why don't the neo-liberal institutions, like the World Bank, the International Monetary Fund, the World Trade Organisation, the European Commission and the US government recognise that their policies have failed? Why do they keep on pushing them wherever and whenever they can?" The answer is not just that institutions are always loath to admit their mistakes, especially when these have killed and ruined so many millions. It is also that these policies have not failed.

To the contrary, they have produced exactly the results they were intended to produce. They have made a tiny fraction of international society rich beyond imagining, they have kept many dependent countries dependent in a new, less visible sort of colonial relationship and they have made so-called free trade, privatisation and unfettered capitalism the rule in countries that previously wanted little or nothing to do with them. Furthermore, they have imposed their policies with relatively little organised protest because their ideology has been expertly produced, packaged and delivered. Ideology can alas have a far stronger influence than facts. This is why we must fight on the practical front, of course, but also -- I happen to believe primarily -- fight the battle of ideas.

In any event, the massive funds belonging to rich people who already have most of the material goods they need or want are generally devoted to more or less speculative investments. Hedge funds, for example, are estimated to be sitting on about three trillion dollars, even today when so many investments

have suffered melt-down. The financial institutions have been frantically innovating, particularly over the last decade. The entire incentive structure of the banking and finance industry has become perverse: the large institutions know perfectly well that they are "too big to fail", consequently they also know that no matter how risky their actions, they will be bailed out by the public purse and has become all too plain. Beforehand, top management takes the money and runs.

Between the years 2000 and 2006, average annual profits of the financial sector in Great Britain averaged 20 percent—that is, two or three times the profit rate of other sectors of the economy. Huge bonuses, especially in the US and the UK, went to a handful of people, intensifying inequalities, whereas millions further down the ladder have lost their jobs and often their homes. Such profits were themselves clearly not sustainable because at some point, financial gain must be based not just on speculation but on the real economy.

Now that the bailouts are coming thick and fast, we have before us a singular example of socialism for the rich, the well-connected and Wall Street, in which the profits are grabbed by the usual suspects and the losses, tremendous losses, are billed to taxpayers. The United States has in effect nationalised these institutions and their debts--without getting anything from the financial industry in exchange.

As the sub-prime crisis has continued to ooze like a giant oil spill over the whole economy, speculators have searched for alternative profitable areas and created the food-price bubble trouble in which we now find ourselves. What happens then? The resource-poor, the world's hungry, grab whatever they can, they chop down trees, kill animals and overexploit what little land they may have. Poverty is bad news for nature. But so is wealth. Even though there are far fewer of them, the rich cause much greater environmental damage with their dinosaurian ecological footprints. People who use the population argument to explain the multiple crises and who see in population control the solution are missing a crucial point—it's not so much the number of people, although numbers are important, as their relative weight.

Furthermore, as we have repeatedly witnessed, the frequency and the fury of storms provoked by global warming hit the poor and the poorer regions of the globe hardest. There is worse to come. We have not even begun to comprehend the perils of climate change, including vastly increased numbers of environmental refugees who will crowd the planet due to droughts, flooding and crop failures. The Pentagon is already working on how to stem this tide by countering by whatever means necessary the refugees frantic efforts to reach more favourable lands. Government planning for this perfectly predictable phenomenon is limited to increased surveillance and security responses, not attempts to make outmigration less necessary. And yet the UN Intergovernmental Panel on Climate Change [IPCC] which is probably the most respected scientific body in the world, has already warned us that in Africa, the yields of rain-fed agriculture are likely to be reduced by 50 percent, deserts will gain ground, species destruction has already reached such proportions that we are in the midst of the sixth geological extinction of the planet's four and a half billion-year history. The fifth extinction was the one that put paid to the dinosaurs.

I could go on drawing out relationships between the poverty, financial and ecological crises but I'm sure you need no more. The question is what we can do about all this and by "we" , I mean people everywhere who understand that the triple crisis is real and urgent.

Knowing that I will doubtless offend a great many people here, let me say straight away that there is an exit strategy, a genuine solution exists, but it is not in my view the one that many well-meaning environmentalists have long advocated. I'm sorry, but the time has passed for telling people to change their behaviour and their lightbulbs; that if enough people do this, then together "we" can save the planet. I'm sorry, but "we" can't. Obviously I'm not suggesting that people shouldn't change their behaviour and their lightbulbs—but even if the entire population of Europe does so—a most unlikely scenario—it's not going to be enough. I agree as well with proposals for localisation and scaling down, but we have also got to scale up.

We need large-scale solutions, sophisticated, industrial solutions and huge involvement of governments in order to cut greenhouse gas emissions drastically enough to save our future. In other words, we must have the courage to challenge not just our political leadership but the entire neo-liberal, unregulated, privatised, capitalist economic system in place in order to provoke and promote a quantitative and qualitative leap in the scale of environmental action. Dare I say it here? Sometimes big can be beautiful and right now is one of those times.

Since I believe that individual and local solutions are necessary but tragically insufficient to address the seriousness and the urgency of the ecological crisis, I will use the rest of my time to discuss the twin problems of how to deal with governments and with the capitalist corporate production and financial system. The dilemma I wrestle with is this: Can we

save the planet while international capitalism remains the dominant system, with its focus on profit, shareholder value, predatory resource capture and with no-holds-barred finance capital making more and more decisions? Can we rescue our natural home when confronted with a powerful caste that does not know the meaning of "enough" and is allergic to the kind of fundamental change a New Ecological Economic Order requires? Can we move forward when governments basically work for the interests of that class?

On bad days I reply No: We can't save the planet. It's impossible to reverse the climate crisis under capitalism. But that is a despairing answer and if true, it means there is virtually no hope. No hope, because I do not see how even the most convinced, most determined people could replace, much less overthrow capitalism fast enough to carry out the necessary systemic change before a runaway climate effect takes hold—always assuming it hasn't done so already. First of all, there are not that many convinced and determined people prepared to act against the dominant economic system and there is nothing that resembles in the smallest degree an avant-garde revolutionary party that might lead them even if they existed. There is no one-size-fits-all replacement solution for capitalism. Considering the historical record and role of such parties and such solutions, I consider this an unmistakably good thing.

But there are other obstacles to once-for-all revolutionary change. Nobody knows, figuratively speaking, who the Tsar is that we would have to overthrow today and nobody has a clue where to find the Winter Palace we would have to storm. We know the Winter Palace isn't on Wall Street which was up and running again a few days after 11 September and is now taking full advantage of the bailouts. The US is only one of many world capitalist centres. Even if we were to win in one place, the nomadic money-moguls would simply mount their camels and head for another. The worlds of 1917 and of 2007 are utterly different, so we must try to move beyond this revolutionary impasse, this dead-end and find a new synthesis.

The question we face is not so much what to do — I think that is reasonably clear and I'm about to spell it out--but whether we will have the intelligence and the strength to seize the great opportunity with which we are now presented. Perhaps the words "great opportunity" strike you as wildly optimistic considering the long and dire preamble you've just listened to. However, I am now going to argue that not only are individual solutions insufficient but that the remedies offered by Kyoto, Bali, Bonn or whatever timid future agreements may be negotiated are tragically inadequate, Once more--I cannot stress this enough--the scale is crucial. And the great opportunity is to be found in the financial crisis itself. Properly targeted and used, it could open the door to the quantitative and qualitative leap we must make.

Some progressive people will reject the solution I propose, but I would then ask them what alternative they offer. The ecological crisis is of a different nature from the financial and poverty crises in the sense that once climate change is underway, as it is now, it is irreversible and we haven't time for theoretically perfect solutions. With politics you can sometimes turn back and start over, but not where nature is concerned. So you can accuse me if you like of suggesting a way to give capitalism a new lease on life and I will plead guilty.

Let's take first the slightly easier question "How can we deal with governments?" at least in the more or less democratic countries. China is another matter. People are generally way ahead of their governments in recognising the emergency. The political issue is not simply to "throw the rascals out" because they would be replaced by other rascals just as bad, just as beholden to the corporations, their lobbies and the financial markets. The trick is to convince politicians that ecological transformation and environmental practices can pay off politically.

This means that citizens, activists and experts, whether they like it or not, have got to work with local, regional and national politicians and governments; help them to find like-minded partners and formulate ambitious projects they can undertake on the broadest possible scale. Citizens, activists and experts must furthermore help these politicians and governments to become shining ecological examples with the electorate by publicising their efforts and their successes. Could the Schumacher Society become a kind of nexus for an ongoing forum of best-standards/best practice, bringing together political decision makers at every level with citizens groups and experts to discuss and carry out the best public-sector initiatives? Politicians must be convinced that these policies will not just work but also be highly popular with their constituencies.

Now let's take the more difficult question of confronting the economic system as a whole. In his book Collapse, Jared Diamond examines several historical cases of social extinction due to over-exploitation of the environment. He identifies several common characteristics. One of these is the isolation of the elites, giving them the capacity to keep on consuming way above ecologically sustainable limits long after the crisis has already struck the poorer,

more vulnerable members of society. That is where we are now globally, not just in isolated places like Easter Island or Greenland.

So how can we realistically combat the ecological footprints of our dinosaur elites, recognising that we don't have the option of shouting "Off with their heads" in some imagined, world-wide revolution. Nor can we force them to change both themselves and the system that serves them so well, whereas we know that we must change that system because it is raping the planet and its inherent logic is to keep on doing so.

I can see only one way out: the coming together of people, business and government in a new incarnation of the Keynesian war economy strategy. I was born in the United States in 1934 and I remember well when the US switched massively to a war economy, converting all the rubber plants in my native city [Akron, Ohio] to production not for private cars and trucks but for the military. There was huge citizen involvement and support. Thousands of factories, research labs, housing projects, military bases, day care centres, and schools were built or expanded during the war. Public transport was improved and worked overtime to move millions of men and women to Army bases or new defence jobs.

Yes, there were still worker-management conflicts and yes, big corporations rather than small business got most of the government contracts but on the whole the workers were well paid, African-Americans and women began making a few modest gains and the whole war effort finally pulled the United States out of the Depression—it was Keynesianism on a huge scale. There was also an elite group of businessmen called "Dollar-a-Year Men" on loan from their companies to the government, who were charged with making sure that military production and quality targets were met. They had enormous prestige—my godfather was one and I was doubtless insufferable bragging to my little school friends about him.

Why am I going back over this ancient history? Because I think we have a similar opportunity today. The US and the world economy are heading downhill fast and the fallout for ordinary people in terms of jobs, housing, consumption and future welfare is going to be grave. If this diagnosis is right, then some new economic tools will have to be used to combat recession and stagnation, simply because the old ones have already been pushed to their limits and have little or nothing left to give.

The way Central Banks and Treasuries usually try to solve financial recession or depression is through standard remedies like interest rate cuts, currency devaluations or incurring new debt—but the United States has reached the end of its leash on that score. Interest rates are already extremely low—although not in Europe, where the European Central Bank and its hidebound president are ideologically committed to the same sorts of monetary policies that prolonged the Great Depression in the 1930s. The dollar is already weak, which makes US exports cheaper, but it can't be devalued much further without risk. Deficit spending is already beyond belief. With the bailout of Fannie Mae and Freddie Mac, the Federal Reserve in effect took on their bad debt and added hugely to the liabilities of the United States Treasury. It risks doing so again. Households too are over-indebted and are losing more equity every day as the value of their dwellings deteriorates.

Since the traditional tools are worn out, the only new tool I can think of to pull the world out economic ruin and social chaos is a new Keynesianism, not military this time, but environmental; a push for massive investment in energy conversion, eco-friendly industry, new materials, efficient public transport; the green construction industry and so on.

Stringent standards for new buildings must become the norm; older ones can be "retro-fitted" on easy financial terms; families and commercial property-owners can receive financial incentives for installing green roofs and solar panels and sell excess energy to the grid. Research and development can be oriented towards alternative energies and strong, ultra-light materials for airplanes and vehicles. Technically speaking, we already know how to do such things, although some clean solutions are still more costly than dirty ones. Mass-produced, they would become less so.

All these new, eco-friendly industries, products and processes would have huge export value and could quickly become the world standard. I am trying to describe a scenario that can be sold to the elites because I don't think they will embrace genuine environmental values and conversion if there's nothing in it for them. But this approach is not merely a cynical attempt to get the elites to move in their own interests. There are also plenty of advantages in such an economy for working people. A huge ecological conversion is a job for a high-tech, high-skills, high-productivity, high-employment society. It would be supported, I believe, by the entire population because it would mean not just a better, cleaner, healthier, more climate-friendly environment, but also full employment, better wages, and new skills, as well as a humanitarian purpose and an ethical justification—just like World War II.

How could one finance such a huge effort? It would have to involve targeted government spending in the

traditional Keynesian sense and governments are bound to complain that they haven't the means to carry out such a policy.

The financial crisis provides the ideal opportunity both to finance the conversion and to get the runaway global financial system under control.

At present, taxes almost always stop at national borders. The secret is to take taxes up to the European level and to the international one through currency and other financial transaction taxes. People who oppose such schemes pretend they are not feasible because one would need to obtain the consent of every national jurisdiction in the world, but that is not correct. In fact, currency and other transaction taxes would require nothing more than political determination, the cooperation of the Central Bank and a few lines of software. For the currency transaction tax first proposed by James Tobin in the 1970s and now considerably refined, the tax base is the currency itself, not the place it's traded. Thus the European Central Bank could easily collect the taxes on any transactions involving euros, the Bank of England the same for the pound, the Fed for the dollar and so on. Since currency trades now amount to $3.2 trillion dollars every day, a tax of one basis point, that is, a levy of one per thousand could raise a tidy sum for ecological conversion and poverty reduction. Britain already imposes a tax on stock market transactions but other European countries do not and should imitate Britain.

Carbon taxes are another much mooted and equally feasible idea. So is a unitary profits tax on transnational corporations, which would require knowing the total sales of the company, the total taxes paid, the sales realised in each jurisdiction and the tax paid in each jurisdiction. If, for example, a TNC reported that in country X, a particularly low-tax jurisdiction, it made 5 percent of its sales yet paid 50 percent of its taxes, the authorities would find it a bit fishy. I'm presenting an extremely crude summary here but believe me, there are experts—bankers, corporate lawyers, fiscal experts and accountants--who know exactly how to do such things. Perhaps to encourage more local consumption, one could also think about taxing the miles travelled by the food we eat and the clothes we wear.

We would not forget the poor countries of the South which are the major terrain of the poverty crisis. Debt cancellation for poor countries that the G-8 has been promising for a decade must finally happen but against the requirement that these countries also contribute to the planetary environmental effort through re-forestation, soil conservation, species protection and the like. They would also be required to involve their own people in democratic decision-making and the funds would be carefully monitored by independent auditors.

Tax havens that allow affluent individuals and corporations to avoid paying their fair share of the conversion should be shut down: it would be cheaper to pay the inhabitants of the Cayman Islands, Liechtenstein and the rest a living wage for twenty years. Plenty of cash would remain for eco-investments, job-creation and poverty relief.

In exchange for their bailouts, the banks and investment houses have to accept regulation—not just regulations to insure transparency and eliminate the incentives for stupid behaviour but also more stringent ones forcing them to participate in the ecological offensive. They should be obliged to devote X percent of their loan portfolios to eco-projects at below market interest rates—which they could make up by charging much higher rates on loans to dirty or otherwise anti-ecological projects. Low or no-cost financing for home conversion projects should be another compulsory priority for banks. This could give a huge spurt to the construction industry.

Nobody is asking for the moon here. Banks would still make loans, finance investments and earn a fair return for their services. Taxes on currency transactions at one basis point are not going to ruin anyone. Unitary profits taxes on large corporations would simply return us to the era when the companies paid their taxes because they couldn't avoid them. The point is that a Keynesian taxation and redistribution system would be invested, nationally and internationally, both ecologically and socially, in education, health care, clean, green energy, efficient water distribution, communications technology, public transport, and various other things the world needs and that we already know how to do. These measures would, in turn go a very long way to creating opportunities for far more people to participate in the new green economy through jobs, life-long education, more social protection and reduced inequality. Getting the present financial crisis-producing, free-flowing, unregulated financial system under public and citizen control is the prerequisite for solving both the environmental and the poverty crises.

In other words, it's a Public Relations dream. Whichever political parties understand this can win on such a programme without anyone having to bring down the entire capitalist system as a prior condition for saving the planet.

A Keynesian ecological programme would furthermore bring many constituencies together in a common cause. As matters now stand, politically speaking, no single interest group can solve the

problem that concerns it most. By this I mean that, by themselves, ecologists can't save the environment; farmers alone can't save family farms; trade unions alone can't save well-paid jobs in industry and so on. Broad alliances are the only way to go, the only strategy that pays. The Global Justice Movement, as international social activists call it, has begun to have some success in working democratically and making alliances with partners who come from different constituencies but are basically on the same wavelength.

Now we must go beyond this stage and attempt something more difficult: to forge alliances also with people we don't necessarily agree with on quite major questions—for example, with business. This can only be accomplished by recognising that disagreements, even conflicts, can be fruitful and positive so long as the areas where it is possible to agree are sought out, identified and built upon. We must find where the circles of our concerns overlap. At least one of those overlaps ought to be saving our common home. I don't see any other way of generating citizen enthusiasm, involvement and the qualitative and quantitative leap in scale that is now required.

I haven't time to elaborate on all the technical details concerning the content and the financing of necessary environmental investments. What I can do is guarantee you that the conversion to a green economy is technically feasible. The schemes for new taxes have been thought through; the industrial prototypes already exist; the machinery is ready to hum into action the moment people can make their politicians accept the challenge. Getting the financial system under control and taxing international capital at quite ridiculously low rates in order to redistribute it institutionally and internationally would be enormously popular. We could seriously attack climate change and eliminate the worst of world poverty within a decade. We are talking politics, not technical aspects here and trying to figure out a way to tame the raging beast, the crisis-producing, free-flowing, unregulated financial system and putting it under public and citizen control.

Capitalism is not sane in the sense that most people understand sanity. We humans normally think about our future, that of our children and the future of our countries and the world. The market, on the contrary, operates in the eternal present which, by definition, cannot even entertain the notion of the future and therefore excludes safeguards against future, looming destruction unless these safeguards are imposed upon it by law.

We need law, for sure, and political forces with the backbone to propose and to vote the law into existence, but we also need to think about human motivation. Remember the prestigious Dollar-a-Year Men of the 1940s and imagine what might happen if we could transpose them into the world of 21st century capitalism. A significant number of contemporary captains of capitalism, all of them with bloated, unimaginable salaries, might be brought to believe that money is all very well, but is there nothing more? Why not found an extremely exclusive Order of the Earth Defenders, or the Environmental Knights or the Carbon Conquerors who alone, in recognition of their special contributions to the national and international environmental conversion effort. They would have the right to display a highly visible emblem on a banner in front of their homes; a fanion on their cars, a green and gold rosette in their buttonholes like the French Legion d'Honneur or a Congressional Medal of Ecological Honour. They would belong to the small assembly of the anointed; those who provide the means and have the honour of saving the earth. Becoming a member ought to appeal to their competitive spirit.

In conclusion, let me say that myth has always been the driving force of every great human achievement, from Greek democracy to the Renaissance to the Enlightenment and the American and French Revolutions. So must it be in the coming age of Ecological Stewardship. To save the planet, we must change, quickly and profoundly, the way the majority thinks and feels and acts, and we must start with the social forces we have right here and right now, and no others. It's no use wishing they were different ones or stronger, or wiser. We must play the hand history deals us.

For such a change, we will need six "Ms", starting with Money, Management and Media. But even more important than these three "Ms", we must try to create a new sense of Mission and Motivation and Myth at the noblest level. "Myth" in this sense has nothing to do with story-telling or lies. It is the grand narrative that empowers us to believe that we can accomplish what we must accomplish. It speaks to the deepest motivations of human consciousness and inspires the desire for honour and for a life's work which transcends death. The elites already have Money, Management, Media. On our side, we have Mission, Motivation and Myth. If we can bring together all these, the future will take care of itself.

And wouldn't that be nicer than having another war?

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By: B. Sivaraman

Indian economy is insulated from the crisis…The global financial crisis will not affect us much…First Chidambaram went on in this vein until both he and his boss Manmohan had to reluctantly admit that no developing economy could possibly remain immune to the global crisis. Still, it was projected primarily as a financial crisis or at best a precursor to a mild recession. But no financial crisis is ever a mere crisis of the world of high finance alone. Just as the gloom on the trading floors soon spread to the shopfloors in the factories, financial turbulence is just a symptom of the turmoil in the real economy.

In a global crisis of such historic proportion where the total bailout packages by all countries work out to some 3 trillion dollars but where there is still uncertainty whether the system can be salvaged, it is stupid to pretend that India would be immune to the systemic crisis. A finance minister's (FM) job is not to give false hopes. Panic at the stock markets cannot be prevented for long with pep words from the FM. Till October 14, the Bush administration alone had announced bailout packages to the tune of over $ 990 billion apart from injecting fresh investment worth $ 200 billion in banks and private financial institutions to shore up their financial position.

The contagion is truly global in a globalised world. How can the high priests of globalisation in India expect to insulate the country from this all-pervasive crisis?! Already the financial crunch is having its impact on the foreign institutional investors' (FII) hot money in India . Just wait for the impact on trade, foreign direct investments (FDI), exchange rates, remittances, balance of payments (BoP), forex reserves and, above all, on the macro-economy in India. Goodbye to the rosy stories of double-digit 'growth miracle', it is now an impending debacle that stares economic analysts in the face.

The possible social impact is mindboggling. The new middle class in India is witnessing its first financial meltdown and a possible deep recession. The information technology – business process outsourcing (IT-BPO) myth would soon be blown. The possible BPO gains could hardly make up for the IT sector losses inflicted by recessionary economies in the developed world. Anyway, if the job losses are already running into lakhs (100,000s) in the US , one can well imagine how much political pressure will build up there against outsourcing. If such leading names like Morgan Stanley, Merrill Lynch, JP Morgan, Goldman Sachs and Lehman Brothers start biting dust and their brightest kids are given unceremonious marching orders, Indian B-school products are surely in for a bad patch. Pre-election political pressure may have forced Jet Airways to take back its decision to terminate 1900 employees, but the job scenario in the so-called high-growth high-wage sectors has already turned gloomy.

All booms in India , based primarily on foreign money, will soon go bust. The recession-ridden US consumer/ industry can hardly sustain the growth miracles of China and India. The surpluses of the Indian bourgeoisie would find a greener pastures in greater and greater acquisitions abroad than investing anew in a dwindling economy at home. Didn't the Swiss bankers' association point out that Indians were holding $1.4 trillion in Swiss banks? A sum about 40% larger than the gross domestic product (GDP)! The only breed that will thrive is the breed of speculators — in stock markets, currency trade and possibly in the real estate, gold and art pieces where the desperate wealth would flow.

In US, if it was first the speculative housing market bubble/subprime and then the financial bubble, in India it has just begun with the stock market bubble and possibly the real estate bubble. When it extends to the investment bubble (what with the special economic zones (SEZs) and other fabulous concessions, the telecom bubble, the IT-BPO bubble and so on), all claims of India having weathered the storm would wither. India perhaps might go under late and might take longer than the rest of the world to come out. All over the world there are 77 tax havens like St. Kitts and Cayman Islands . But in India there are 580 SEZs!

The Immediate Impact on Indian Stock Markets

The festival season in India was seldom so gloomy for the share market. Investor wealth worth Rs. 250, 000 crore (1 crore = 10 million) was wiped out on the bourses on a single day, on 10 October. The Sensex fell by 1000 points before recovering some 200 points, an intra-day drop of some 800 points. The lachrymal wave washed away the festive mood.

At the first sign of stock market crash and FII funds stampede, the United Progressive Alliance (UPA) Government has once again permitted P-notes (participatory notes) paving the way for enhanced speculation. The present convulsion in the Indian bourses would look mild before any possible explosion in future as a result of this heightened speculation. Despite the government itself acknowledging that the P-notes were being abused/misused at the time of banning them, no safeguard has been put in place.

Anyway, how can there be any safeguard within the realm of speculations? It is absurd.

Impact on Indian Banks

"Indian banks are safe," reassured Reserve Bank of India (RBI) Governor Subbarao repeatedly. Indian banks' exposure to international markets is relatively small at 6 percent of their total assets, the rating agency Crisil said, adding that even lenders with large international operations have less than 11 percent of their assets overseas. But a mini-version Indian bailout was in the making simultaneously in the first week of October with the government virtually shoring up two mutual funds and Life Insurance Corporation (LIC) coming to the urgent rescue of three more which landed into liquidity crisis in the backdrop of a steep crash in the stock markets.

At a time when the big names in Western banking industry are queuing up for bailouts, there may be a sudden leap in non-resident Indian (NRI) deposits in Indian banks as these funds would look for a safe haven back home. We can hence expect a big clamour from the NRI lobby for greater concessions for their deposits. The RBI recently increased the credit cost on term borrowings (with more than 7-year maturity) to Libor+4.5% and even then the big Indian corporate names are finding it difficult to raise funds amidst the present turmoil. Indian borrowers will end up paying more for the foreign lenders and Indian banks might be forced to pay more for the NRIs – all in the backdrop of a creeping recession and falling rate of profits.

Even when Chidambaram was preparing to pass some 66 reforms-related pending Bills in possibly the last session of the parliament and a committee had prepared a blueprint for major financial sector reforms, the US financial crisis fell like a bombshell. No doubt, the UPA ideologues would also use the global meltdown as a pretext to push the same risky reforms. In the years to come, as the new investment projects go under one after the other and investors and insurance companies and hedge funds go under trading in credit default swaps and all such devices, the financial crisis here in India might be the denouement rather than the beginning as in US. ICICI, the symbol of new breed of unscrupulous financial manipulators, is already in doldrums.

Increasing Liquidity

Liquidity position in India is comfortable, said RBI Governor Subbarao after a slew of measures. But he avoided hinting at any possible reduction in prime lending rates. The liquidity position may be comfortable, the banks and financial institutions might be slush with funds once again but with interest rates ruling high there is no pick up in the credit offtake by SMEs (small and medium enterprises). As they are the main employment providers in the industrial sector, the employment in this sector has already taken a heavy toll. A deep and prolonged recession in the West might result in unemployment for millions of these workers.

The RBI hurried to cut Cash Reserve Ratio (CRR) by 150 basis points to 7.5 per cent, releasing more than $12 billion fresh liquidity into the Indian banking system. But if mere money supply alone can drive the economy and industrial growth forward uninterruptedly, then no economy will ever face any recession and there cannot be a meltdown of this nature. However, amidst all-round alarmism and panic reactions, confidence building itself has become the main plank of economic policy!

The government has once again liberalized ECB (external commercial borrowings by corporates). It is a different matter that in the light of the meltdown nobody would bother to take a second look at dollar bonds issued by Indian banks despite all their backing by the Indian government and hence they are abandoning the idea raising external funds/ borrowings. While RBI might come forward to infuse liquidity liberally in the short-term, wait for the booming NPA figures in the medium and long term.

Exchange Rate: Rupee Depreciation

When the western economies are going into a tailspin one after the other, the appreciation of dollar and euro looks somewhat paradoxical. From unprecedented appreciation earlier a few months back, the rupee fell to record low — reaching Rs.49 per dollar at some point. The dollar is gaining vis-à-vis rupee because of the outflow of the FII funds and since the worst is yet to come in the US /global meltdown, a repeat of the East Asian crisis in India is very much a possibility. During the preceding period, if the rupee appreciated by around 18%, now it has depreciated by around 19% during this Jan-Sept.

The exporters who were crying earlier are happy but it is now the turn of importers to come to grief. Not many people know or remember that manufacturing imports had overtaken total domestic manufacturing production in the domestic organised industrial sector this year. Apart from cost escalation and consequent reduction in profit margins, just wait for the impact of the rupee depreciation on inflation. The confident prediction of possible fall in inflation rate to single digit by January sounds hollow in the backdrop of this as well as the cut in CRR rates and other measures by the RBI aimed at increasing the liquidity.

Impact on Trade

The trade deficit is reaching alarming proportions. If exports are growing, imports are growing even more.

Thanks to workers' remittances, NRI deposits, FII investments and so on, the current account deficit at around $10 billion doesn't look so threatening. But for some reasons if the remittances dry up and FIIs funds take flight, it will be a repetition of 1991 after a few years if forex reserves get depleted and trade deficits keep increasing at the present rate. Even as the country's exports and imports registered a substantial growth of 35.1 per cent and 37.7 per cent in dollar terms, respectively, during the first five months of the current fiscal (April to August), the trade deficit during the period has shot up. The trade deficit was around $14 billion for a single month of August 2008, a record level. Even Goldman Sachs' prediction that India 's forex reserves would decline to $271 billion by year end from $310 billion in March 2008 looks a very conservative estimate.

Unprecedentedly high forex reserves were becoming a burden. As most of these funds were in dollars, the government had parked most of them in US treasury bonds or invested them in securities and bonds in foreign banks. With the meltdown and consequent poor returns following rate reduction, these treasury investments have taken a beating. The government had its fingers burnt with the earlier dollar depreciation. A part of these funds could have been used to clear some of the external borrowings. Now with the recovery of the dollar, repayment costs in rupee terms have also shot up. A golden opportunity was missed. The government was toying with the idea of establishing a wealth fund/SPV (Special Purpose Vehicle) with these reserves to finance private parties taking up infrastructure projects through PPP. But, despite all the hype, the PPP has been a total flop so far.

An Indian Recession?

It might be just a slowdown in India till now. But a recession cannot be ruled out in the medium term. Chidambaram claiming 7.5 - 8% growth this year. ADB has predicted 7% growth. Many rating agencies estimate industrial growth between 6.5% and 5.2% from around 11-12% in 2006-07. It is hoped that agriculture would be the saving grace this year thanks to a good monsoon. But just recall that Chidambaram was boasting about a possible 10% growth early this year after the budget and the situation has changed!

True, there is a boom in FDI this year. The total FDI between April and August this fiscal stood at $14.6 billion. A record figure. Average monthly FDI inflow is above $2 billion whereas a few years back that was the annual figure. Kamal Nath was confidently asserting that the target of $35 billion for this year would be achieved. But a closer look reveals that a sizable chunk of this FDI going into mining loot, services, financial services in particular, entertainment industry including luxury hotels and so on and also on mergers and acquisitions (M&As) not mainly to fresh investments in the core productive sectors alone. The long-term sustainability of such a pattern of FDI flow is anybody's guess. Especially, in the midst of the global liquidity crunch. Inflows into already committed projects might give a false impression and it remains to be seen how long this boom will continue. To sustain it, Chidambaram is bound to come up with a slew of fresh liberalisation measures. FDI caps in insurance, banking and financial services are already being hiked. There might be 100% FDI in single-brand retail. There will be more and more sellouts to attract foreign capital. Chidambaram keeps repeating ad nauseam that India , like China , will continue high growth despite recession in the developed countries.

Well, if high growth is to be driven primarily by foreign capital assisted by government landgrab, tax waivers, assured returns guarantees for infrastructure investments and fabulous BOT terms and so on, in short, by making the whole of India into a tax haven, the structural distortions this Manmohan gamble would lead to is mindboggling. Leaving a handful of big business houses and Indian MNCs, nothing Indian would be left in the "Indian" economy. And even the " India " MNCs have started looking outward. India Inc spent $26 billion in mergers and acquisitions abroad this year. The global meltdown would, if anything, only accelerate this trend and the scarce capital resources would be channelized for overseas spending. If this is the story of overseas M&As by "Indian" companies, M&As in India by foreign companies is even more breathtaking. In power sector alone, the merger and acquisitions worked out to $5 billion out of a total M&A value of $55 billion in the infrastructure sector alone. This is the secret behind the high FDI. But overseas M&A is not a rosy path. Tatas teamed up with AIG which was one of the first to go under. TCS, Infosys and WIPRO…all were on an acquisition spree abroad but at home they are the leading ones in issuing pink slips.

The nation would soon realize the real cost of the N-deal. N-deal was also a sort of bailout for the US industry. Kakodkar has once again made it clear that 20 nuclear reactors would be set up! How in the given situation the governments would foot the bill in the next ten years?

The Deflating Growth Bubble

And what about the growth story? Well, the ratio of savings and investment to the GDP reportedly remains high at 35 per cent. So far so good. Still, there is a slowdown in the Indian economy. The core sector

growth is down to less than 4 per cent. All vital productive sectors are on a slowdown. With such a structural background, if and when the Indian economy slips into a recession, the recession will be protracted and there will be no a quick revival. Crude oil prices have declined to $80 a barrel. The monsoon has been good in most parts of the country. For a couple of years it is not difficult to continue with the growth story. But infusion of liquidity, i.e., increasing the velocity of circulation alone in other words, can hardly sustain production. The basic structural flaws are bound to come back to the fore and haunt.

The problem might be made to look minor — as that of liquidity — at present but if there is a severe constraint in demand then no amount of infusion of money into the system and supply side magic would be able to save it. And given the fiscal scenario, the government would not be able to go for any fresh neo-Keynesian binge either, leave alone any major corporate bailout as in the US . Pay commissions and loan waivers might sustain aggregate demand for a couple of years but signs of slowdown are already on the wall. Despite repeated promptings of Chidambaram, the bankers are not ready to reduce even the home loan rates and not just the prime lending rate for the businesses. After all, they are hardnosed businessmen and they will continue to be top executives in their banks while Chidambaram and his party might go out of power.

The 11th Plan estimates that to maintain an average annual growth rate of 9%, the investment in infrastructure would have to rise from Rs. 259, 839 crore in 2007-08 to Rs. 574,096 crore in 2011-12 at constant 2006-07 prices, aggregating to Rs. 2,011,521 crore over five years. In the terminal year, this works out to be 9 per cent of the GDP, up from 5 per cent of the GDP in 2006-07. The Plan document itself says that the government cannot manage this much money and a substantial part of it has to come from the private sector. PPP is supposed to pave the way. But what is the record so far? The Government of India's Committee on Infrastructure which monitors PPPs notes that 244 PPP projects are ongoing and another 76 are in the pipeline in the country. The total capital outlay in the ongoing projects amount to a minor fraction of the total projection by the Planning Commission. To finance infrastructure projects, the Government of India (GoI) established an India Infrastructure Finance Company Limited (IIFCL), a wholly Government-owned company to provide long term finance for infrastructure projects. According to the IIFCL website, it would provide loans upto 20 per cent of the project cost and projects "awarded to a private sector company ... [a company established] through Public Private Partnership (PPP) shall have overriding priority". And how big is this IIFCL? The GoI has successfully persuaded the World Bank to give it a loan of a meagre Rs.2700 crore to finance projects worth Rs. 2,011,521 crore! Making bogus projections to justify pro-private sector policy changes is the thriving industry in India . In such a situation, can any sizable fund flow into the risky infrastructure sector of a developing country amidst tottering private banks and investment funds?

Many approved SEZs are in doldrums as they are not getting any units and this whole thing is a massive real estate speculation of gigantic proportions. Even though the real estate speculation in India is taking a different trajectory and is not as reckless as credit instruments without any backing by collaterals as in the US subprime, the real estate bubble centering around SEZs landgrab is no less serious. Despite RBI's reservations, the banks were competing to lend to SEZ promoters and even the nationalized public sector banks accumulating huge NPAs would be lined up for private takeover. SEZs might finally achieve what Narasimham's two reports could not achieve. If millions of home loan borrowers are defaulters, the banks can take back their houses. Even they can takeover the SEZs. But if they themselves go deep into the red irretrievably, they themselves would be taken over. Companies incurring loss too would be taken over by stronger sharks. After a wave of takeovers, if the economy doesn't revive, this would only amount to taking over the losses. A massive collapse in asset prices is the ultimate eventuality.

Social Impact

'Suicides after market crash is an urban trend' …screamed the headlines in a pink paper. Beneath that was the sob story of an entire family committing suicide after heavy loss in the stock market. "Whether it is a seemingly well-to-do US-resident of Indian origin wiping out his entire family or middle-aged brother-sister duo killing their parents and then committing suicide, the financial crisis has hit everyone, and has hit them hard", the report added. At least, the desperate farmers go alone leaving their family members in the lurch. But the scorched middle class investors take their entire families along and that is the level of urban investing middle class insecurity. This explains the golden age for gold as investment in yellow metal is considered safer. Just think of the hundreds of new scrips by companies with ambitious investment plans counting on these investible surpluses of the middle classes and also the market opportunities opened up by their wealth. All these plans for new scrips will be scrapped. The middle class boom might be glamorous but the depression in incomes and losses in the markets are far more agonizing. Pink slips are painful indeed and joblosses are not limited to the West

alone. Those who are hoping that jobs in the West would shift across to the cheaper shores of the India are missing the point that domestic job losses due to recession in the West as well as a slowdown in India would far outweigh such outsourcing gains. Even the real estate boom is going bust in Bangalore , the Indian El Dorado.

The Indian BPO sector derives 40 per cent of its revenues from the financial sector of the developed countries and exactly as they mushroomed fast they will wilt with the same speed. IT-BPO sector in India accounts for 5.5% of the GDP but 30% of exports and a very high share of service sector employment in cities like Bangalore . El Dorado is poised to turn into a hell!

Take the case of garments and textiles. Hardly a few months back, tens of thousands of workers, mostly women, were out of jobs in Chennai and Bangalore and towns like Tiruppur and Karur. The villain was the rupee appreciation, leading to some 18% reduction in incomes in rupee terms. After the loot by layers and layers of intermediaries, the factory producer was left with nothing and hence closed down the unit. Now dollar has appreciated, smile returned to the faces of garment owners but the smile soon vanished. The current exchange rate offers handsome returns but the orders are drying up due to impending recession. No margin then…no orders now! No jobs in both the scenarios.

The impact on the working class by means of wage compression and workloads, illegal retrenchment and worsening of job security and working conditions etc., would be onerous. Already this has started happening. For reasons of space, we are not elaborating. But we can only say there will be many more NOIDAs.

The employment in organised industrial sector – both public and private – was 8.98 million in 1997 but it was down to 7.62 million by 2005, i.e., precisely during the growth miracle if we leave out the disastrous year of 2001-02 for the industry when the growth was very low. If the growth miracle turns into a debacle what will happen to organised sector employment? Formal sector will be informalised and permanent workers will be booted out.

Bailouts for the bankrupt and boot-out for the workers. The same logic of capital! Total blackout of the possible social impact of the meltdown and almost virtual absence of any discourse on safety measures/ nets is one of the characteristic features of the current crisis of capital, across the globe as well as in India.

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Europe

France: Journalists strike over Sarkozy's television reforms

Journalists at France 3, the national network of regional channels, went on strike on January 5; their colleagues at France 2, the main public-owned national channel, went on strike on January 6.

President Nicolas Sarkozy is pushing ahead with reform of French public TV (France Télévisions) through parliament. The reforms aim to strengthen governmental control over France Télévisions by eliminating advertising, making public TV completely dependent on state funding, while also allowing the government—effectively, the president—to name its CEO.

The reforms have met with significant opposition amongst television journalists. According to Variety, around 40 percent of France Télévisions' staff struck against the amendment on November 25. According to local news reports, the recent protest involved mostly local stations and suggests some 90 percent of regional staff did not report to work, disrupting programming and news coverage.

Sarkozy is seeking to dress his reforms as the setting-up of a commercial-free, government-supported public broadcaster modelled on the BBC in the UK. But TV workers fear it will strengthen Sarkozy's control over the media, by allowing the government to appoint France Télévisions' head, previously chosen by broadcasting regulator, the Conseil Superieur de l'Audiovisuel.

The privately owned TF1, France's leading broadcaster, which belongs to Martin Bouygues, one of Sarkozy's closest friends, is expected to benefit from windfall profits as well as from changes to the viewing schedule in relation to TF1's main entertainment programme agenda.

Private channels will be allowed to broadcast up to nine minutes of advertising per hour, instead of the previous six.

Critics have accused the president of attempting to destroy public television, which he sees largely as an institution staffed by left-wing journalists. According to the Irish Times, when a journalist at Radio France recently interviewed the Green deputy Noel Mamère, a critic of Sarkozy's, "two executives appointed by the president burst into the journalist's office demanding why he dared broadcast the interview."

UK/Channel Islands: Woolworths' staffs protest after being told "no redundancy pay"

One hundred twenty workers employed by Woolworths in Jersey have launched a petition after being told they will not receive redundancy pay.

The workers were told that UK statutory redundancy payouts do not apply on the Channel Islands. According to the BBC, administrators did consider making a special payout to Jersey staff but decided it would set a difficult precedent. Over 2,500 people have signed the petition launched by staff at the King Street store in St. Helier.

One Woolworths' worker, Anne Marie Le Bloas, said workers were only told five minutes after the shop closed for the final time that they would not be getting a redundancy package. BBC business correspondent Martin Shankleman said it is understood the administrators had already taken the decision not to make a special case of the Jersey employees. The correspondent was told the firm could have paid for the redundancy themselves.

UK: Bus drivers in 24-hour strike over pay

Around 300 bus drivers in parts of northwest London went on a 24-hour strike on January 5 in a pay dispute. The workers are employed by London Sovereign in Harrow and Edgware. The company operates 12 routes throughout northwest London.

The union Unite said its members earn £6,000 less than those working for other bus companies and want a pay rise.

Middle East

Egypt: Strikes and sit-in by Nile cotton workers

Around 180 workers at the Nile Cotton Ginning Company in el-Mahalla el-Kubra staged a sit-in at the company's headquarters on January 4, according to a report in Al-Masry Al-Youm. Around 200 workers in Eitay el-Baroud, in the governorate of Beheira, went on strike, while 350 protested in Menya City on non-receipt of their December wages. Hundreds of workers protested in the company's Mahalla, Beheira and Minya branches.

Protesting workers in Gharbia called on President Hosni Mubarak, the prime minister and the manpower minister to intervene. A worker in the storeroom of the company's Mahalla branch told Daily News Egypt that around 126 workers began the sit-in.

According to the news reports, the workers are demanding the payment of their salaries no later than the 27th of every month, the payment of incentives, a rise in their social bonus from 10 percent to 30 percent like public sector workers, and the appointment of an auditor by the state to run the company and manage the workers' share of stocks (10 percent).

Rabea Ali Hassan, a member of the company's trade union, said that the company plans to pay out only half of the workers' entitlements in order to force them to resign ahead of the sell-off of the company's land and assets.

Africa

Nigerian doctors' strike goes ahead despite threats of dismissal

Doctors in Lagos State, Nigeria, went on strike on

January 5 after their three-week ultimatum ran out with no offer from the state government. The doctors were protesting their conditions of service and demanding the implementation of the Consolidated Tertiary Institution Salary Scale (CORTIS).

According to allAfrica.com, the strike was solid at all the state-owned hospitals across the area. Its correspondent at the Lagos State University Teaching Hospital, Ikeja, reported that "activities were paralyzed due to total compliance by house officers while only a few consultants were seen attending to patients in critical conditions." At Massey Street Children's Hospital in Lagos Island, only a handful of senior medical personnel were seen attending emergency cases.

The State Health Commissioner, Jide Idris, had threatened to dismiss any doctor who complied with the strike call, but this had no effect on the doctors' determination to win their demands. Referring to the threats of dismissal, Doctors Guild Chairman Ibrahim Olaifa said, "Let him go ahead and do it if that is the best approach to solving a problem as serious as what we have."

Also in Nigeria, a national strike by judicial staff that began in November last year is still ongoing. Their union, Judicial Staff Union of Nigeria (JUSUN), said that it had sent 20 letters asking the government to restart negotiations, but the government had not replied.

Latin America

Mexican trade unionists to mobilize over minimum wage

In Colima state, Mexico, the Trade Union Front is planning to mobilize the region's workers to protest the insufficient increase in the Mexican minimum wage, the high cost of living, increases in fuel costs and usurious credit card interest rates. Tentatively, the protest will take place next week. The front was formed by 30 trade unions, representing 20,000 workers.

The Front's coordinator, Leonardo Gutiérrez Chávez, emphasized the high cost of basic foodstuff, which is causing misery among Colima's workers. "We are inviting all workers to form part of this front," declared Chávez. "We must begin with a series of mobilizations."

The global recession is having a brutal effect on the Mexican economy. Chávez indicated that there is widespread agreement that there will be no GDP growth this year. "This means increasing unemployment and plant closures, something that is of great concern for the working class."

Chávez also denounced the paltry 4.9 percent increase in the Mexican minimum wage for Colima, short of the 6.27 percent needed just to keep up with inflation. Both minimum wage workers and higher paid workers are entering 2009 with less buying power than in 2008.

Argentina: Unemployed set up soup kitchen at economic minister's home

Workers recently sacked by Envases de Plata, a manufacturer of aluminum containers, set up a soup kitchen at the home of Economics Minister Carlos Fernandez. The workers are also occupying the Envases plant in the Buenos Aires suburb of Quilmes.

The sacked workers, who were laid off in October, are owed wages and are demanding that they be rehired. Argentina, like most of Latin America, is beginning to feel the effects of the global economic crisis.

United States

Poultry strikers in Ohio face harassment

On December 19, striking Case Farms poultry workers in Winesburg, Ohio found that vandals had burned their strike shed and painted the adjacent road with homophobic graffiti. Union members went on strike in July 2007 after rejecting a 15-cent-an-hour raise. Strike organizer Tim Mullins believes the most recent action against the strikers constitutes a hate crime. The local sheriff rejected the suggestion.

Strikers have faced other harassment, including the spreading of manure on fields adjacent to the strike zone, corn-harvesting equipment spraying workers with husks and cobs, and the weekly tipping of the strikers' portable toilet.

Asia

Hong Kong airport ground staff strike

About 1,000 ground staff at Hong Kong Airport Services struck for three hours on December 27 affecting over 80 flights and leaving thousands of passengers waiting for hours for their luggage.

The ground staff were protesting a company decision to scrap an annual performance-based bonus of approximately one month's salary for its 3,000-strong workforce. Management claimed it could only pay a bonus of $HK750 ($US96.2) because of "the economic downturn". This was rejected by employees whose monthly salaries range from 6,400 and 10,000 Hong Kong dollars.

The union rejected a second company offer to pay a half-month's salary but called its members back to work when management agreed to enter negotiations on January 5.

Chinese garment workers protest

Hundreds of workers protested outside a garment factory in the southern manufacturing hub of Guangdong on December 29 after the death of a colleague, which they claimed was caused by overwork. The employee, a factory chef in his 40s, had worked more than 10 straight days before his death.

The chef's family and factory workers were not satisfied with compensation provided by the factory and have threatened to maintain their protest until the issue is resolved. There has been no official report on the cause of the chef's death.

Thousands of Korean media workers strike

Members of the National Union of Media Workers from

120 South Korean television and radio stations walked off the job on December 26 in protest against government plans to deregulate broadcasting ownership and competition laws.

New government legislation would allow some of South Korea's largest newspapers and corporate conglomerates to hold a 20 percent stake in terrestrial broadcasters, 30 percent in comprehensive channels and 49 percent in news-only channels. Comprehensive channels deal with all content, including news, entertainment and sports.

Some 2,000 media workers, including reporters and producers from the top three broadcasters—KBS, MBC and SBS—rallied in central Seoul. Three days later they demonstrated outside parliament and have vowed to continue their protests until the Grand National Party government abandons what media employees have described as "evil legislation".

Indian coalminers protest

Coalminers picketed the Central Coalfields Limited (CCL) headquarters in Ranchi, Jharkand on December 26 to demand a change in the Indian government's wage policy. According to Coal Ministry policy, miners' wages can only be revised every 10 years. The coalminers want a salary increase after five years.

The picket was to block Union Minister of State for Coal Santosh Bagrodia from entering the CCL building. Coal workers have threatened to launch a three-day strike if their demands are not fulfilled.

Indian loco drivers on fasting protest

Three members of the All India Loco Running Staff Association, supported by 100 colleagues, began a fasting protest in Bangalore, Karnataka on December 29. Their demands included lifting assistant loco drivers' pay to 2,800 rupees ($US57) per month and the establishment of distinct wage grades to correspond with functional differences.

The workers also pointed out that there are no promotional opportunities for drivers who are forced to work for 12- to 13-hour shifts.

Junior doctors in India strike

Junior doctors at the Government Medical College in Kozhikode, Kerala held a 24-hour strike on December 31 as part of state-wide agitation for a monthly salary increase. The doctors only worked in the Emergency Services during the walkout.

On December 15 most medical services in Uttar Pradesh were suspended as junior doctors held an indefinite strike to demand salary and allowances as per the recommendations of the Sixth Pay Commission. Around 600 junior doctors from Chhatrapati Sahuji Maharaj Medical University also boycotted work and picketed the hospital premises.

In Allahabad city, Motilal Nehru Medical College medicos called an indefinite strike and rallied outside the Swaroop Rani hospital before marching to the college. Strike action by junior doctors was already underway in Jhansi district.

Meanwhile, the S N Medical College principal declared strike action was banned under the Essential Services Maintenance Act (ESMA).

Retrenched diamond polishers in India rally for jobs

Around 400 unemployed diamond polishers rallied in Varachha, Surat City on December 29 to demand jobs. The factory owner offered 1,500 rupees and household items as relief until he could reemploy the polishers. This was rejected by the protesting workers, who said they wanted "jobs not money".

The polishers agreed to move into the factory and begin negotiations following the arrival of the police and representatives of the Surat Diamond Association, Surat Diamond Workers Association and Labour Department officials. The factory owner agreed to increase his relief offer to 2,500 rupees and gave an assurance that he would reemploy the workers when he reopens the plant.

Thai auto workers demonstrate for bonus

About 400 subcontract workers from the Thai Summit Auto Body Industry Co Ltd in Samutprakarn (29 kilometres south of Bangkok) rallied outside the company premises on the Bangkna-Trat Road on December 24. Traffic was blocked for several hours while workers negotiated with management for a year-end bonus.

The protestors also demanded that the company hire subcontractors as full-time employees, withdraw lay-off plans and not penalise the demonstrating workers. The company has 2,000 employees with around 600 contract personnel.

Workers dispersed after management agreed to pay all subcontractors a bonus equivalent to 300 days' pay. Those with less than six months of work will receive 600 baht ($US17.20).

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