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Prague Global Policy Institute – Glopolis

January 2009

Grand plans, money and falls – seeking values and answers in the financial crisis

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The Czech Presidency of the Council of the EU comes at a watershed period. Europe and the world are being shaken by a global crisis. Many people agree, however, that the watershed concerns more than just the economic crisis. Every crisis is an opportunity for reflection and change. The current global financial crisis indicates that after 25 years a **change in political thinking** is once again impending. Coming into play are new forms of economics and politics, lifestyle and international order. The attempt behind this thinking is to begin with an understanding of the underlying causes of the existing situation and an analysis of the main problems and to add a revision of the values that a few modest contributions to the discussion on possible alternatives can offer.

The great political changes of the 1980s are behind the current financial crisis. The restriction of state power, removal of borders and release of market instincts bore fruit, but also brought local crises and global problems. The explosion of money without rules led to collective risks, debts and private profits without frontiers. **Pride comes before a fall.** This fall not only culminated in a collapse of prices, the evaporation of billions in assets and global recession, but also revealed a breakdown in values and the unsustainability of the existing economic model. The paths forward should therefore not ignore the need for not only greater stability, but also for greater social equality, preservation of natural capital and democratic control of the market and the state.

THE GRAND GLOBAL IMBALANCES

Crisis from global liberation

But simply, the current financial crisis is primarily a result of excessively speedy, often forced and **uncontrolled economic globalization.** Like trade liberalization and deregulation, the policies of financial globalization failed to take into account the institutional and political readiness of individual countries. Paradoxically, in 2007 this financial globalization burst forth and impacted most in the United States and the United Kingdom, whose political decisions in the 1980s to restrict the role of the state and to expand markets to the maximum and across the board, both home and abroad, launched this "second wave" of globalization. It is only fair to remark, however, that following a quarter century of (neo)liberal reforms, the United States in particular are the architects of their own misfortune in the same way as the victims of the political decisions of other countries, especially in Asia.

As Financial Times commentator Martin Wolf remarks in his most recent book, "The era of financial liberalization was, in short, an **era of crises**"[1]. Before the crisis hit the global financial centres, the liberated and minimally regulated global capital flows in combination with bad macroeconomic policies caused more than a hundred crises with high economic, fiscal and social losses – not to mention the losses in environmental capital and democratic sovereignty.

According to a study by American economists, the world witnessed in the period 1973-1997 a total of 139 crises (of which 95 were in emerging economies and 44 in wealthy countries), compared to only 38 crises in the period 1945—1971. In fact, according to the authors, in comparison with the period prior to 1914 the **crises are twice as numerous** today[2].

Smoke, but don't inhale

The logical answer to these crises for many developing countries became an economic model aimed at **production for export** and capital export (more specifically, the current account surplus). The main lesson was not to allow excessive external debt over which they could have no control. A key instrument, alongside improving macroeconomic and financial policies, was pegging the (mostly undervalued) exchange rate against the dollar and the outcome was the accumulation of foreign currency reserves (mostly in dollars). The emerging economies significantly tightened the rules for becoming indebted and for internal consumption.

An **undervalued exchange rate** ensures them competitiveness on the strongly liberalized and competitive global market. Exporting capital prevents the threat of financial crisis and offers a possibility for putting aside savings until such time as the country is capable of absorbing them securely and effectively (their investment in the USA, however, is neither profitable nor one hundred percent secure). Export-driven growth then allows for relatively safer domestic economic development and the influx of foreign direct investments, including access to the technologies and know-how the developing countries need.

Some economists call this policy "exchange rate protectionism" or "exchange rate dumping", because the rate is not primarily driven by the market and provides a competitive advantage over countries that do not want to, or cannot influence their exchange rate. In view of the high degree of dismantling of trade barriers and the binding of economic policies by global regulations, the developing countries do not, however, have at their disposal many other **instruments of policy control (policy space)** over their own economic development.

1 M. Wolf, Fixing Global Finance, Baltimore, The Johns Hopkins University Press 2008, pp. 31

2 B. Eichengreen, M.D.Bordo, Crises Now and Then: What Lessons from the Last Era of Financial Globalization? National Bureau of Economic Research Working Paper 8716, January 2002, www.nber.org

Asia does not then spend its dollars saved and acquired from trade surplus and foreign investments at home, but rather recycles the capital back and exports it, as the oil countries do with their export profits. Martin Wolf says metaphorically that East Asia "smokes, but doesn't inhale" its capital. This costs their **consumers, employees and taxpayers**, the vast majority of whom are still considerably poor, a great deal. In particular, they must prevent the growth of foreign currency reserves projecting into inflation ("sterilization" is a budgetary expense), but wage growth is also restricted by attempts to maintain competitive production prices (but even Germany has made use of this kind of wage dumping). A series of bureaucratic restrictions also arise from this economic model, e.g. the Chinese are not allowed to buy assets abroad.

Debts as well as money for the rich

We are detached witnesses to a considerably perverse condition, where, instead of the flow of capital from rich to poor countries, money flows in the opposite direction to the world's richest country. In China alone there are up to 800 million poor people, but the Chinese do not consume even half of their own GDP[3]. On the other hand, up to USD 800 billion (70%) of global savings end up each year in the USA, which has thus become the largest **global consumer and debtor.** In other words, the world's largest net exporters pay the United States to consume their goods as well as the capital that had earlier caused them great economic instability.

Nonetheless, the recent experience of developing economies with crises has shown that in a global world this voluntary export of capital is still less costly than the consequences of wild outflow of capital, freezing of credit, currency collapse, debt crises and economic recession. The flip side of greater control over one's own economic development, however, is the fact that countries with capital surpluses thus import labour, but **export instability** from liberalization (back) to the USA and Great Britain.

The influx of cheap imports restricts demand for domestic production (and pushes prices and wages down), but all citizens also require work and income and their own economic growth. Domestic consumption represents 70% of American GDP, so the government and the Central Bank, in order to maintain employment, must stimulate the economy with the aid of massive public investments and private investments assisted by low interest rates. This makes the already cheap dollars from Asia and the oil countries even cheaper in the U.S. and inflates the price bubble of a whole range of assets (real estate and securities). However, both the American government and the American public (but not companies) are spending money that is not theirs. If the price for having work in China is low wages and widespread restriction of consumption, then the price for having work in America is excessive consumption and **massive debt**. Americans take out loans for their current consumption and will have to repay them from their future earnings.

CHEAP MONEY WITHOUT RULES

Living on debt and cheap money, however, has fundamental impacts not only outwards, but also, and especially, inwards. The majority of economists concur that the eternally growing American trade deficit is unsustainable in the long term, but the net influx of capital (current account deficit) to a sensible extent is. Change is usually conducted by means of adjustment of the foreign currency exchange rate. The gradual **weakening of the dollar** really is occurring, which, advantageously for the USA, raises import prices on the one hand and lowers the cost of US debt on the other. Both of these factors, though, are against the interests of contemporary American creditors and the risk cannot be ruled out that they will cease to finance the American deficit and get rid of their dollars.

It appears for now, however, that the Asian and oil economies are ready to use their foreign currency reserves for the very purpose of preventing further weakening of the dollar resulting in strengthening of their own currencies. In the absence of strengthening of the currencies of the USA's key trade partners, and especially of a slowdown in their current account surpluses, the trade deficit can only be rectified slowly and with difficulty, but the interest of the big trading partners, especially China, in the stability and gradual resolution of powerful **global imbalances** is equally as strong as that of the USA. The question then is not so much whether the dollar should be devalued or not, but rather how quickly, how much controlled and under what conditions.

The price for the cheap dollar

The gradual weakening of the dollar, and especially its instability, creates problems in today's globalized world, however, for other, especially poor citizens of many countries. This is because the dollar is the main trade and reserve currency. The falling buying power of the dollar puts pressure on the developing countries to strengthen their foreign currency reserves even more, and on commodity exporters to increase their export prices.

Oil, natural gas and the majority of mineral raw materials and food commodities are sold for dollars. If their sellers want to maintain their profits in their own currency, they must compensate for the weak dollar by increasing export commodity prices. This, however, raises the global **commodity prices** for all consumers, irrespective of whether they can afford it or not (although there have also been other factors behind the growth in oil and food prices in recent years, including financial speculation). And for all countries dependent on imports of basic commodities this increases the likelihood of inflation, trade deficit and debt.

Many developing countries therefore keep their **foreign currency reserves** in dollars – reserve resources in the event of a disadvantageous development of their own currencies (e.g. financial crisis, such as the Asian crisis in 1997) for cases where it is necessary to buy quickly a large amount of money or goods that are inaccessible for their own currencies. The lower buying power of the dollar and especially sharp fluctuations on the currency markets compel them to maintain higher and higher dollar reserves at the very moment when they need to invest this money instead into building schools, hospitals or roads.

Trap or intention?

The inward impacts of the great global imbalances seem to be even more serious. The American deficit as such represents

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3 M. Wolf, Fixing Global Finance, Baltimore, The Johns Hopkins University Press 2008, pp. 46

a greater problem for the United States than for the rest of the world (which has been more or less satisfied with it). This is not at all because the USA is insufficiently solvent (its debts are in its own currency, and so in the worst case it can always pay them by printing new dollars), but because of the growing **financial vulnerability** of the indebted economy. And it is through the very financial crisis spreading from the USA that the great global imbalance further impacts heavily on the whole world.

The efforts of the American Fed and the government to prevent as far as possible, by monetary and fiscal expansion, an increase in US unemployment (in the face of cheap imports) also resulted, however, in the systematic and long successful **prevention of smaller crises**[4]. These have a curative effect on the market economy, but are socially unpleasant and especially destructive to the financial sector. It therefore remains a subject of fervent debate[5], whether the Fed could have prevented the expansion of price bubbles, excessive debt (at the cost of considerably lower financial sector profits) and therefore the depth of the current crisis. In other words, whether the policy of cheap money was merely a consequence of the influx of global savings or also a reflection of the specific interests of the influential financial sector.

The credit-driven economic growth led to bad investments, wild speculation and lack of transparency also due to moral hazard. The long-term practice of **privatization of profits** (neo-liberal policy in a time of growth) and **socialization of losses** of the financial sector (Keynesianism in a time of crisis)[6] led to reducing individual risks (and at the outset also to a range of positive economic and social benefits in the rest of the economy), but at the cost of a creeping, postponed explosion of systemic risks (with a shattering impact on the rest of the economy and the rest of the world).

Money spoils people, it is said, but big money spoils the financial markets, too. In any case, **super-cheap loans and lax regulations** led to the massive debt of American households, supported the fairytale profits and cancerous burgeoning of the financial sector and discredited in the eyes of Americans and other nations the financial markets and the existing model of (financial) capitalism. How, in concrete terms, did the current financial crisis come about?

GRAND FINANCIAL EXCESSES

Risks without frontiers

The American market directly launched the financial crisis with high-risk sub-prime mortgages. The trust that ever more Americans would be capable of repaying their loans for new housing reached its inevitable limits in the summer of 2007. It reached these limits, however, at a time when too many of these high-risk mortgage agreements had already been signed for lending institutions to be able to simply write them off without large-scale losses, as would have been the case in traditional banking. Professor Nouriel Roubini of New York University estimates that up to 60% of all mortgage agreements concluded in the period 2005-2007 contained disproportionately risky – "toxic" – elements[7].

The mortgage boom came about mainly because other financial institutions (e.g. investment banks) were buying these contracts from the mortgage banks in the belief that, due to close-to-permanent economic growth (especially real estate price growth), they would be capable of selling them on at a profit on the financial markets in the form of diverse **structured financial instruments** (in particular collateralized mortgage obligations – CMOs). Contrary to the mainstream economic theory, with the rising price of a range of financial instruments, the demand for them did not drop, but rose, and with them rose the price of real estate, which in return again increased profits from mortgage financial instruments. The price bubble continued to expand.

CMOs are a type of the more general **collateralized debt obligations** (CDOs). The basic idea is simple: to transform a given type of debt (mortgage package, corporate loans, bank bonds etc.) into a security, the yields on which are differentiated according to the extent of risk of debt default of the various sub-groups in the package. More conservative investors (e.g. pension funds and insurance companies) would invest in about 80% of these securities (based on creditworthy mortgage debtors) with a higher rating and lower earnings. More aggressive investors of the hedge fund type would invest in the remaining 20% of the portfolio with high-risk, high-yield debts, composed of risky debtors. Structured finance for the most part, however, has many more levels of risk and yields. A debt obligation (mortgage package) also presents, as an asset, a collateral countervalue, which the investor, in the event of a problem, can take and sell on the market (at the residual price).

The trick was in that the mortgage institutions thus transferred a large part of their risk to other financial players. Instead of their main earnings coming from interest, they charged fat fees. This led not only to the abandonment of lending caution, but even to directly seeking high-risk clients, who could be transformed into higher-yield securities. This process of structured securing and transfer of risk (called **securitization**) also became very widespread in investments or speculations into other financial assets (shares, bonds, loans), including their collateralizing and an explosion of loans for their purchase. It tied together the vast majority of participants in many financial markets to the point where there was talk of de-risked markets. Few considered the possibility, however, that what worked for individual companies or operations would not work for the entire market.

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4 See G. Cooper, The Origin of Financial Crises – Central Banks, Credit Bubbles and the Efficient Market Fallacy, New York, Vintage Books 2008, pp. 139

5 The same point also made by M. Wolf, Fixing Global Finance, Baltimore, The Johns Hopkins University Press 2008, G. Cooper, The Origin of Financial Crises – Central Banks, Credit Bubbles and the Efficient Market Fallacy, New York, Vintage Books 2008 and Charles R. Morris, Trillion Dollar Meltdown – Easy Money, High Rollers and the Great Credit Crash, New York, PublicAffairs 2008

6 See M. Wolf, Fixing Global Finance, Baltimore, The Johns Hopkins University Press 2008, pp. 22, G. Cooper, The Origin of Financial Crises – Central Banks, Credit Bubbles and the Efficient Market Fallacy, New York, Vintage Books 2008, pp. 161

7 N Roubini, The Risk of a Systemic Financial Meltdown: The Twelve Steps to Financial Disaster, in John Mauldin's Outside the Box, Investor Insight Publishing, February 11, 2008, pp. 2, http://www.signallake.com/innovation/TwelveStepsToFinancialDisaster021108.pdf

Debts without frontiers

Loans became the **basic method of financing** not only of routine business, but also of domestic consumption and especially investments into financial assets. Debt is today the main engine of economic growth.

If the anticipated profit from investment is higher than the interest on loans for this investment (positive carry), or the anticipated level of the debt is lower after the operation than before it (speculation in a fall in the currency exchange rate – short selling), then it pays off to borrow. As long as the prices of assets continue to grow, trades of this kind are a mere technical or mathematical matter. The changeover to electronic trading and the possibility of achieving profits from insignificant price differences or movements brought to the financial markets complicated **mathematical models** for calculating risks and yields.

This also worked for a long time. Even strongly speculative investments with a relatively long-term return were paid for by short-term loans and the ratio of debt/liability to equity grew greatly. **Leverage**, the financial speculation/risk ratio, increased greatly. A good yardstick is the proportion of credit to real production. Charles Morris states that until recently the sum of all financial assets – shares, bonds, loans, mortgages, that constitute a claim on something real (a share in a company's ownership, real estate etc.) – was roughly equal to global GDP. Today their value is close to four times world GDP. Financial derivatives – a form of claim on a financial asset – have a nominal value amounting to ten times global GDP[8].

Thanks to the removal of regulation, a number of **"innovative" financial products** appeared on the financial markets and sold briskly due to the constant supply of cheap and freely available money. These included sophisticated financial derivatives (one of the most popular was credit default swaps, the total volume of which reached USD 45 billion) and significantly toxic products, such as various types of bad mortgages and other risky loans. All of these, however, were packaged into many widespread financial packages along with healthier liabilities.

So many financial products were coming onto the market and were trading between practically all the market players with such speed that very many buyers were unaware what kind of pig in a poke they were buying. The real hope of quick, high profit and the fact that almost everyone was buying and mutually securing each other not only distorted the **real risk** in the eyes of the financial traders, but also led to the systematic undervaluation of risks by specialized ratings agencies and especially the regulatory bodies. But asking for high yields with low risk is like wanting a good bath without getting wet.

Profits without frontiers

Today, global production of traded goods and services is in the range of USD 30-40 billion annually. The turnover of global financial transactions prior to the crisis, however, reached around USD 3 billion *daily*, i.e. more than twenty times the volume necessary for trading global production in the real economy[9]. The remainder consists mainly of **speculation and investment in financial assets.**

The difference between speculation and investment is given by the degree of risk, i.e. it depends on one's point of view of what is risky. They have, however, one thing in common – an attempt at ever greater profits. In the USA and Great Britain, finance has a more than one fifth share in GDP, while industrial production accounts for only around 13%. Nonetheless, the share of **financial sector profits** in total corporate profits in the USA and UK reached as much as 35% at one time, according to G. Soros[10].

The most aggressive players in the global casino, such as **hedge funds**, were in the good years (e.g. 1995-1997) capable of offering investors a more than 20% average profit margin on invested capital. This margin understandably fluctuated wildly. In the crisis period of 1998, it fell to -0.4%, only to shoot up again in 1999 to 23.4%[11]. However, while in times of crisis the real economy also goes through a downturn, in times of economic boom even much lower margins are very attractive, especially when you compare them, for example, with the interest rates offered on your current account or fixed-term deposits. Not even the yields of the stock markets can equal them, although in reality they compete with them for investors' favour.

According to former banker Charles Morris[12], however, profits from hedge funds represent 20-30% of total bank profits. They lend them the capital for necessary increases in their leverage, which can reach as much as 1:100! Other aggressive players also work with a high level of debt and speculation – **private equity funds**, which are not far removed from tunnelling or looting companies. Their strategy is to buy a business on credit, take its cash as their profit, restructure it to impress the markets (e.g. by laying off part of the workforce) and if possible resell it at a profit.

A billion dollar reward for a similar operation involving a firm with a value of four billion is no exception, nor are 10 million dollar annual salaries and 100 million dollar bonuses for the top managers. This is a reward not for the creation of value, but more for the clever **shifting of value**. The attempt at rapid, high rewards for such risky business is understandable, because the chances that it will "go bust" are constantly growing.

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8 Charles R. Morris, Trillion Dollar Meltdown – Easy Money, High Rollers and the Great Credit Crash, New York, PublicAffairs 2008, pp. xii

9 Herman E. Daly, Joshua Farley, Ecological Economics – Principles and Applications, Island Press, Washington, 2004, pp. 256

10 G. Soros, The Economy Fell off the Cliff, The Spiegel Interview with Goerge Soros, 24 November 2008, http://www.spiegel.de/international/business/0,1518,592268-2,00.html

11 P. Wahl, Superstars in the Emperor's New Clothes – Hedge Funds and Private Equity Funds: What is at Stake?, WEED Briefing Paper, 2008, pp. 16, http://www2.weed-online.org/uploads/hedge_private_equity_funds.pdf)

12 Charles R. Morris, Trillion Dollar Meltdown – Easy Money, High Rollers and the Great Credit Crash, New York, PublicAffairs 2008, pp. 111

SEEKING VALUES

The fall of assets

The similarly indebted and unregulated financial sector is like a house of cards or a pyramid set on its apex. Price bubbles for individual assets can burst without threatening the whole system. In the case of the enormous **credit bubble**, which, with the aid of financial innovations and complicated derivatives, securitization and high leverage, has transformed debt into the main investment asset, the only counter-value of which are unrealistically high prices of variously packaged ones and zeroes, this is not possible. The house has collapsed.

Debt default has brought a halt to further loans. The sub-prime mortgage market collapse has brought a freeze to the entire mortgage market – it has crossed over from residential mortgages to the commercial mortgage market and on to the consumer loan and credit card markets, from which were stricken the company loan market and the entire banking sector with the bond and insurance markets... simply the **credit crunch**. Companies stopped borrowing.

They stopped believing in further growth in asset prices and the prices began falling. Assets pledged in exchange for loans ceased to be sufficient collateral. Investors began asking for their money back. The fire sales of assets only deepened the fall in their market price even further. A state of balance is essentially foreign to the financial markets – that which does not grow, dies. The self-fuelling growth was superseded by **self-fuelling decline**, which was only to be halted by the promise of enormous cash injections and rescue packages paid for with taxpayers' money.

The fall of economies

The freefall of financial asset prices has triggered a series of accompanying processes. The bursting of the mortgage bubble – the 20-30% fall in American real estate prices means that almost overnight the **assets** of American households invested in real estate lose USD 4-6 billion in value. As many as 10 million households may as well put their house keys in an envelope and send them back to their bank, because their houses have less value than their mortgages. Securities covered by mortgages (e.g. CMOs) are losing most of their value and many of them will be suddenly worthless.

Their owners must at best write them off in their accounts and increase their financial losses. In the worst case, if they do not have sufficient assets that still have some market value or their own capital to pay off their debts (in the case of companies with high leverage), they will **go bankrupt** or someone with stronger capital will buy them out at a fraction of the usual price. Following the bankruptcy of Lehman Brothers and the collapse or takeover of the remaining large investment banks, the entire investment banking sector vanished.

At this moment, though, the non-financial markets and the entire economy have long since been afflicted. The stock markets are beginning to re-evaluate the prospects for economic growth. The financial crisis has crossed over into the other sectors of the (real) economy, and from the USA to the rest of the world. The **drop in demand** and new loans is now very clearly projecting into a downturn in investment and production, lay-offs, limited consumption and imports, as well as, for example, growing intolerance towards immigrants. Hanging in the air is global recession, in places even depression and deflation. The crisis is also affecting public budgets and civil society everywhere in the world.

The fall of values

The euphoria from the unlimited growth in profits without risk was superseded by fear, panic, distrust and discredit. The decline of the financial markets means more than the depreciation of private assets (wealth, albeit virtual) to the tune of a billion dollars. The sight of how many of assets and how much work of tens of thousands of great minds suddenly have no **real, lasting value** takes the breath away. Nonetheless, it would still be possible to shrug it off as the problem of a small group of rich people, if it were not for the fact that the crisis had such real impacts on the lives of millions of people whom Wall Street had never seen.

The financial crisis directly brought the necessity to increase massively the already dramatic taxpayers' debt as a result of rescue packages. But the crisis also led to the erosion of other, **non-economic values** – further accountancy machinations, distorted incentives, financiers' irresponsibility and insatiability and asocial behaviour. It revealed the massive shift of wealth to a rich elite and a shift in capital to the detriment of labour, the taxpayers and the other sectors of the economy to various extents also in all the rich countries. It also exacerbated a whole range of problems in the developing countries.

The crisis is still shaking confidence in the financial markets and the very moral foundations of Anglo-Saxon capitalism, and casting doubt on the sustainability of globalization in its present-day form. Obviously, the picture is not entirely black and white. A quarter century of financial deregulation, liberalization and expansion under the banner of the **efficient markets ideology** supported the healing of the American economy in the 1980s and global economic growth. It brought an important increase in material living standard in the rich countries, and in several poor ones. The price for it, however, is high.

The fall of the model?

The crisis only reminded us that this growth was in no case either universal, or sustainable, because it took place at the cost of **debt of others, nature and the future.** Whether it is ideological blindness, bad government policy or, on the contrary, the very efficient lobbying of particular elite interests that carry most of the blame, the especially non-economic cost of the current model of economic globalization consists of deeper inequities, environmental unsustainability, instability and restriction of democracy.

It has worsened the life prospects especially for the poorest countries and has led to even wider social polarization within states. It has carelessly set in motion massive consumption of energy and natural resources, in particular fossil fuels, by which it has undermined global economic stability and artificially raised prices of basic commodities. It is now by itself bringing instability and restricting effective governance. Moreover, this growth has spread throughout the planet many deep and costly economic crises, which have not, however, prevented the accumulation of systemic instability in the global economy. The growth of risks in all societies due to the universal **increased dependence** on global markets, especially financial markets, then accompanied restriction of governments' room for manoeuvre and democratic control.

There is no clear, never mind painless, way out of this deeper crisis – all would have palpable negative impacts on the USA as well as the rest of the world. Prevention of global spread of the economic crisis is not possible for three broad reasons: 1) the enormous economic interconnectedness of today's world (liberalization), 2) increased systemic importance and the influence of finance on the real economy (financialization), and 3) as a consequence of the absence of public control instruments (deregulation policies and restriction of state influence). **Multiple global crises** as usual impact worst on those who have the least capacity to protect themselves (influence and wealth) within states and between them.

SEEKING ANSWERS

Discussion on the solution will be lengthy and complicated. The answers to the financial crisis will logically focus on the immediate crisis itself rather than on the underlying causes. Even partial reactions and solutions, however, will have an influence on the degree and nature of systemic changes that are hanging in the air. The contribution of civil society will probably develop from efforts to rectify the aforementioned three main systemic problems of the contemporary global economy:

Deregulation – but watch out for the state!

The actual responses of governments to the financial crisis only underline their political statements – the **return of the state** and regulation is a natural and desirable return of a deflected ideological pendulum. The massive rescue packages at the cost of taxpayers' money (socialization of losses) will not go through this time without the acquisition of a share of private assets (temporary nationalization), the establishment of public supervision and stricter rules and their more consistent enforcement.

Global accountancy standards and requirements for greater transparency of various financial instruments and players, including hedge funds, special investment bodies, credit default swaps and financial derivatives in general, off-balance sheet items and over-the-counter transactions, as well as a revision of capital adequacy, rating agencies and executive compensations to financial managers – all of these points of the **G-20 work programme** will certainly lead to a restriction of the marketplace and motivation for hazard operations.

The free-market ideology in the last quarter century, however, was much purer in theory than in practice. It is not out of place to speculate whether without the influence of the state (especially moral hazard as a consequence of crisis prevention) market excesses would not be significantly smaller. This does not reduce the responsibility of financial managers for outrageous risks, machinations and fees, but the present reactions of governments indicate that they must have had the unspoken consent, if not the active support of the state. The key question therefore remains, whether it will be possible to set efficient and democratic public control not only over the financial markets, but also over the financial policies of states.

Liberalization – think locally!

In its immediate reaction, the chief representatives of G-20 and other multilateral fora were almost surprisingly united in agreeing on the necessity of maintaining an open trading system. It is no wonder, because the rich countries and the big emerging economies are more or less those who gained the most from globalization, or are still gaining today. **The voices of the "bottom billion"**[13] – without the institutional framework necessary for successful integration – are lacking in this group, as are the voices of their own, various, local communities, farmers or local businesses, for which liberalization – without sensible internal profit distribution and damage compensation – was a net loss-making business.

Irrespective of the various motives and impacts of liberalization, globalization created a system of close international economic, and therefore also political interconnectedness. The consumption today of some is the work and income of others. To a greater or lesser extent, all countries are directly, if not equally, **dependent** on this system and changes in its rules require time-consuming and complicated international negotiations. Quick changes – various types of crisis or enforced reforms – for the most part bring big problems.

The series of financial crises has shown that neither the developed economies nor the emerging, developing economies can be net recipients of excess capital. The ability of the poorer countries to gain from global financial markets is still very limited. This is not a reason for absolute rejection of free capital flows, but rather an argument for selective, considered and voluntary liberalization (not only of finance, but also of trade). The capacity of many developing countries to draw on foreign resources will certainly increase, but this must take occur especially and primarily through the building of strong **domestic markets and local institutions**, which represents a great challenge for the area of development cooperation.

Financialization – sound limits to money!

The influence and advantages of the financial sector as such are talked about on an official level more than cautiously, if at all. Thanks to attempts at better regulation, a series of specific measures have been put on the table, which could contribute to the **weakening of financial dominance**. The above extract from the work agenda of the G-20 summit is a very welcome start.

It does not, however, deal with other, more fundamental problems. The high risk of financial operations is supported by more or less explicit guarantees of the state that it will rush to the rescue whenever financial crashes threaten systemic instability. The **systemic importance** (and political influence) of the financial sector (and the dependence/vulnerability of society) are also exacerbated, however, by attempts to privatize public services,

13 See P. Collier, The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It, New York, Oxford University Press 2007

such as pension funds and supplementary insurance, private loans for tuition fees or health insurance, building society savings and other state-subsidized financial services.

Last, but not least, **taxation policies** are also important. Apart from the fact that many of the above-mentioned and other financial services enjoy state support, guarantees or tax exemptions, capital gains tax has for a long time enjoyed one of the lowest rates (significantly lower than taxation of corporate profits, never mind individual incomes). This is very much linked to liberalization and therefore the global mobility of capital, which creates tax competition between states. Its most extreme form is exemplified by tax havens, which not only push taxes, transparency and responsible accountancy downwards, but also actively facilitate tax evasion and capital flight from the rich, and especially from the poor countries.

CONCLUSION

These key problems are so far absent from the official reform agenda, as is the link of the financial crisis to the parallel, albeit temporarily suppressed **food, energy and climatic crises**, which require much deeper analysis and discussion.

Hence, in conclusion, a few questions that need to be further explored: Is the significant shift in responsibility for the organization of the economy from the markets to public institutions, especially states, merely a temporary reaction to the economic downturn without a change in policies or a more long-term retreat from the discredited ideal of a universally efficient market (market fundamentalism) and the accession of a more pragmatic **collective management** at various levels? Is it the accession of efficient or populist governments? Will the current crisis be an excuse for the accelerated or rather postponed changeover to a more sustainable **low carbon economy**? Will the potential new – or green – capitalism finally offer **more equal distribution** of old or new resources between the rich and poor? And will the present shifts in international politics to the benefit of the developing countries (for example G-20) bring **participation in decision making** only to the big, successful economies, or also to the small, fragile states and the poor communities within their borders?

The just starting Czech Presidency cannot answer these deeper questions, but it can do much to indicate the prevailing direction of the answers. The contribution of civil society to discussions on answers to the financial crisis will be conducted in an attempt to bring into the debate these wider or marginalized, old and new factors. For the non-governmental and non-profit sector, the crisis should also be a reminder of what a high **political matter** the economy is and how badly we have neglected financial literacy, public awareness and political discussion on these influential phenomena.

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13 viz. P. Collier, The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It, New York, Oxford University Press 2007

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