

Debttonation: how globalisation dies

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by Ann Pettifor

A single day, 9 August 2007, will go down in history as "debttonation day" - the beginning of the end of the deregulation and privatisation of finance that marks the era of globalisation.

It is a moment that I (alongside many others) had long predicted, most notably in an article for openDemocracy written in 2003 (see "The coming first world debt crisis" [1 September 2003], and my book of the same title [Palgrave, 2006]). The problem, as with Cassandras in other areas of life, was to gauge the precise timing of the global financial crisis that we knew was approaching.

A vital piece of evidence emerged in June 2007, when news broke that the New York-based Blackstone Group LP - the world's largest private-equity fund - had decided to go public. In other words its private owners had resolved (to the puzzlement of many) to make some activities transparent, and offer the company (both assets and liabilities) to shareholders. Many attributed a charitable motive to the company - a desire to ensure that the "little people" as well as the rich few should share in Blackstone's wealth (little mention was made of its losses).

It was at that point that the timing of the "debttonation" appeared imminent. It took two more months.

The problems revealed by "debttonation day" amount to a "system-crisis" that goes to the heart of the financial model which underpins that ephemeral economic concept, "globalisation" (see Tony Curzon Price, "The end of gentlemanly capitalism", 13 August 2007). It is the deregulated finance sector that has undermined the power and effectiveness of governments, and forced open capital and trade markets. It is deregulated finance that has forced down the price of labour, demanded excessive returns both of labour and the ecosystem, and further benefited the already very rich, most notably private-equity and hedge-fund managers and investors. And it is deregulated finance that has drowned the world in debt, and now precipitated a worldwide market crisis.

The bitter truth of grand market failure on 9 August 2007 is that when the financial sector faced meltdown it had to rely on the state - in the form of central banks in United States, Europe and Japan alike - to intervene in order to restore a semblance of stability. In the real world, citizens and taxpayers are once again obliged to bear responsibility, and pay the costs incurred by the reckless and unrestrained greed of the world of high finance.

Blackstone itself reinforced this message in a richly revealing statement released on 13 August. The company announced record profits for 2006-07 - though (as Bloomberg notes) it reported "a net loss of \$52.3 million, or 20 cents a share, from June 19 to June 30, the only days in the period it was structured as a public company" (my italics).

The blindness of orthodoxy

The result of the financial-market "debttonation" is that the world faces a lengthy, painful and borderless depression.

The institutions most susceptible to the siren voices of the finance sector are in immediate danger. They include banks that have gambled by lending recklessly (estimates range from \$400 billion upwards) to finance huge leveraged buy-outs, mergers and acquisitions. They hoped to play "pass the parcel" with these debts, and forward them on to other investors - but suddenly there are no takers. The next in the chain of vulnerability are companies - from Manchester United to Boots - that have burdened their shareholders, employees and consumers with debt.

But it is not the leading backers and officials of these institutions, the hedge-fund managers or private-equity owners, who will be most hurt by the "debttonation". It will be everyday citizens, many of whom will have been persuaded to borrow far beyond their means to pay, who will lose their pensions, homes, jobs and livelihoods - and their hoped-for futures. In doing so, they have propped up the global economy for the last two decades - yet they, not the "guardians of the nation's finances" (central bankers, finance ministers and regulators) will be forced to carry the blame for the crisis.

The full extent of the pending financial collapse is dawning on regulators and central bankers, whose panic led them to reverse their anti-inflationary policies and instead pump liquidity into a financial system frozen by the fear and mistrust that now exists between banks. On 13 August, the European central bank made its third consecutive daily injection of cash into the European banking network, bringing to almost \$280 billion (£140 billion) its aggregated support for

eurozone banks. Comparable amounts of cash have been provided to financial institutions in the US and Japan.

Why have central bankers, all ideologically committed to the role of the "invisible hand" in financial markets, acted in this way? Because commercial banks no longer trust the solvency of other banks, and so on 9 August effectively went on strike; i.e. stopped lending to each other, forcing central bankers to step in to provide lending to those that needed it. The fact that central banks continue to do so today, indicates that regulators are in a bind: they have lost faith in the "invisible hand", but have not yet dealt with the solvency issue. As a result, fear still stalks the markets, and easy money continues to be passed around as if there were no tomorrow.

But while central bankers are no longer "asleep at the wheel" others remain in deep denial. Speculators in stock markets, politicians and economists - including International Monetary Fund (IMF) economists - continue to rely on flawed, ideologically-driven economic analyses.

The fund issued a statement on 10 August, saying: "We continue to believe that the systemic consequences of the reassessment of credit risk that is taking place will be manageable. The fundamentals supporting strong global growth remain in place."

IMF economists, like all those in thrall to the dominant orthodoxy, have a blindspot about finance. Economists conduct their analyses without reference to the creation of credit and debt, focusing instead on goods and services, supply and demand. They regard money as "neutral" and on the whole ignore the role of credit. As Joseph Schumpeter once wrote, economists treat the "phenomena of economic life ...in terms of goods and services, of decisions about them, and of relations between them. Money enters the picture only in the modest role of a technical device that has been adopted in order to facilitate transactions." So the Bank of England's model of the United Kingdom economy has no debt components. True, it is recognised that there are, every so often, monetary "disorders" - but money is "of secondary importance in the explanation of the economic process of reality."

This explains economic orthodoxy's blindspot and its continued indifference over the creation of today's gigantic credit/debt bubble. It also explains why the IMF believes that "underlying economic fundamentals" bear little relation to the collapse of confidence in a finance sector overburdened by debt, excessive gambling, speculation and profit-taking. A speech on 31 July 2007 by IMF deputy managing director, John Lipsky, was remarkable in this respect:

"The fundamental underpinnings of the current global expansion appear to be reasonably solid. If so, the current market strains most likely will help set the stage for both financial and fundamental adjustments. These, in turn, will help set the stage for a new leg of the global expansion."

In other words, the failure of the privatised financial system, the threatened collapse of banks, the bankruptcy of mortgage companies, the collapse of private-equity deals, the burden of unpayable corporate debts, the systemic effects of the sub-prime lending crisis, the repossession of private homes - all these "adjustments" do not threaten "fundamental underpinnings" but rather set "the stage for a new leg of global expansion".

This is delusional, a profound failure of economic analysis by establishment economists and by those charged to act as guardians of the finances of nations. As a result these policy-makers will weaken and delay the right policy responses - which will prolong the crisis further.

A politics for economics

Where are the politicians in all this, amid a crisis that affects the lives of millions of people who are also democratic citizens and voters?

Those in Britain who have backed the City of London in its role as financial centre, and overseen and cheered on the deregulation of the finance sector, seem to have been struck dumb. At the time of writing, there has been no word from the country's prime minister (and ex-chancellor) Gordon Brown, current chancellor Alistair Darling, or indeed the mayor of London, Ken Livingstone. However, even as concern about the financial markets pushed share prices worldwide into slump on 9 August, President Bush used his White House press conference to comment on the issue.

He said the US economy "remains 'the envy of the world', enjoying low unemployment and inflation.....I am told there is enough liquidity in the system to allow markets to correct". Like the orchestrated statement from the IMF, these remarks were intended to restore confidence. They brought to mind the "spin" put on the great crash of 1929, when an earlier Republican president - Herbert Hoover - was encouraged not to refer to financial "panics" as this induced further panic, and so the word "depression" was invented to describe the collapse of the economy (spin-doctors today have devised an even more evasive phrase: "growth recession").

On 29 October 1929, the day when stock prices hit their lowest point and over \$30 billion disappeared from the American economy, the elderly JD Rockefeller was encouraged (no doubt by another eager public-relations person) to issue a statement:

"These are days when many are discouraged. In the 93 years of my life, depressions have come and gone. Prosperity has always returned and will again."

Twenty economically destructive years and a world war later, prosperity began to return. But only because governments had learned, at the feet of John Maynard Keynes, that the finance sector had to be humbled, and restored to its role as servant of the global economy, not master. Governments had to take back powers to control flows of capital and the creation of credit - powers that the private sector had so recklessly deployed in the 1920s. A generation after they were learned, those lessons were deliberately abandoned: after President Richard Nixon precipitated the collapse of the Bretton Woods system in 1971, governments inspired by free-market ideology surrendered control over and regulation of the finance sector. A series of world leaders has refused to intervene, or to coordinate at G8 summits, to restore balance to a global economy suffering from excessive credit creation, asset-price inflation and severe trade and financial imbalances.

Now, after "debtomation day", the lessons Keynes taught will have to be relearned if stability and sustainable prosperity are to be restored to the global economy. The prolonged financial crisis in prospect guarantees that the process will be painful.