In the midst of a change of paradigm?

The financial crisis, Latin America and the future of capitalism

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As the world struggles with overcoming the financial crisis, much of the most dominating policy-making of the last couple of years and decades is being turned on its head. The conventional wisdom is under revision, and some of the most conservative international commentators – like the Economist and the Financial Times – are questioning the future of capitalism. Hence in the long term, the results of the present crisis may not only be financial meltdowns, mass unemployment and increasing poverty, but also a change in the paradigm for economic policy. But while such a change is necessary, it is far from certain that it will happen.

To understand the dynamics of economic policy-making in the light of the crisis, one has to understand the drivers of the crisis itself and the discussions around it. In this article, I therefore first provide a brief overview of the crisis, with a particular emphasis on its impact in Latin America. Before looking at its causes, I compare it to the crisis of the 1930s. I then show how warnings of such a crisis as the present were ignored. Finally, I return to the question of the likelihood a change of paradigm.

The financial crisis erupts and turns economic

While the present crisis can be traced back to events occurring before people started talking of a crisis, the crisis itself has taken shape over just two to three years, with visible escalation of it occurring in the last quarter of 2008.

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The first signs of a financial and subsequent economic crisis appeared when the house price bubble in the US burst in 2006. Mortgage backed securities immediately lost value, but it wasn't until the summer of 2007 that the sub-prime mortgage market totally crashed. When that happened commercial banks lost trust in each other and the inter-bank market, which is where banks lend to each other, started drying up. Later, when the bank-losses became more apparent, the strains in the inter-bank market intensified, and many banks in the US turned to Asia and the Middle East for additional capital.

In the summer of 2007, a hedge fund of the investment bank Bear Sterns broke down and the British bank Northern Rock experienced a bank rush not seen for decades. In the early parts of 2008, Northern Rock was nationalised by the British state and Bear Sterns sold at 6% of its market value to J.P. Morgan Chase in a deal that included the US' Federal Reserve underwriting USD 30 billion worth of bad assets.

From September to October 2008, the financial crisis seriously erupted. The investment bank Lehman Brothers collapsed and set off a chain of failures in other banks and investment institutions. Bank of America took over Merril Lynch, AIG Insurance got USD 85 billion from the US state, and large banks like Washington Mutual and Warchovia went bankrupt. A banking crisis erupted in Iceland and several banks in the UK, Belgium and the Netherlands were nationalised. Share prices plummeted and most countries in Europe enacted bank-rescue packages. Indeed to save the financial system, governments find cash and other public funds to an extent that they had been nowhere near mobilising before.

With an almost unprecedented collapse of the world of finance – the estimated loss of financial wealth at the global level is USD 50 trillion or the equivalent of one year's global GDP – the financial crisis turns economic. Throughout 2008 economic forecasts are continuously down-written. In the beginning of the year, growth in 2009 in the US, Europe and Japan was expected to be between 2% and 3%; at the end of the year these economies were predicted to contract with between 1% and 2%. Large parts of the world are already in a recession by the second half of 2008, and the last quarter of that year see some of the largest recorded drops in output in most of Europe, North America, Japan and South Korea. International trade, which has increased year on year for decades, takes a major blow and plummets at a speed no one had imagined. If it wasn't for stable growth in some large emerging economies, the whole world would be in recession.

Today, we are much aware of the consequences of this crisis: the ILO has estimated that the number of unemployed people may increase with more than 50 million in 2009 and that some 200 million workers could be pushed into extreme poverty. The number of working poor, those working but unable to lift themselves and their families above the 2 dollar a day poverty line, could rise to 1.4 billion. That is 45 per cent of the people employed in the world. In Latin America too, unemployment, which stood at 7.3 per cent in 2008, is set to rise.[1]

The impact on Latin America

As the financial crisis unfolded, many observers speculated that their might be a de-coupling between the advanced economies in North America and Europe on the one side, and the emerging and developing economies in the rest of the world on the other side. However, already towards the end of 2008 it was apparent that no such de-coupling was taking place. Rather, and as expressed by the Chief Economist of the OECD, we were witnessing a super-coupling. No part of the global economy was immune from the crisis. Quickly, all economies became affected in their financial sphere, through their real economy or both.

Latin America has showed greater resistance to the financial turmoil than other parts of the world, also than other regions of emerging economies, notably Asia. Commercial banks in Latin America have not been substantially exposed to the so-called 'toxic' financial assets that are the direct cause of most of the bank losses in 2008. They have also focused more on domestic markets and hence been less vulnerable to external shocks. Moreover, the region has been helped by stronger supervision and prudential regulations than other parts of the world, which is an inheritance of the crises of the last ten to fifteen years.

Nevertheless, the impact has been substantial. The losses of financial worth due to the crisis so far are estimated to be USD 2.1 trillion or 57 per cent of GDP. In Asia on the other hand, such loses stand at 109 per cent of GDP. Of the losses in Latin America, USD 1,261 million has happened in stock markets, USD 291 million in private and public debt and USD 567 million in other bank assets. From June to December 2008 alone, the stock market index in Argentina fell by 51%, in Brazil it dropped by 49%, and in Mexico valuations declined by 29%.[2] The depreciation of many Latin American currencies vis-à-vis the US dollar has increased the dollar value of all these loses.

Though Latin America may have been less severely hit by the collapse of the financial sector, the crisis in the real economy will be dead serious. The tightening of credit conditions and slowdown in global economic activity is already having a strong impact in the region. Hence, economic growth in Latin America is expected to fall from 4.5% in the previous year to less than 1% in 2009, possibly just around half a per cent.

Falling sources of income and revenue

Latin America is affected through developments in trade, remittances and tourism as well as flows of foreign direct investment. As noted already, trade volumes are declining for the first time in many years – and are, by the IMF, expected to do so by at least 3% in 2009. The economies of Latin America have generally become more open to international trade up through the 1990s, and had a relatively stable ratio of exports to GDP of 21% before the crisis. The decline in commodity prices – which all in all dropped by 45% in the second half of 2008 after having had a bubble-like character – has already resulted in a sharp decline in export receipts for many countries, particularly those dependent on exports of raw materials. Indeed, for at least nine Latin American countries, commodity revenue made up at least 2% of GDP between 2002 and 2007. For Trinidad and Tobago and Bolivia, respectively, this share has recently been as high as 22% and 12% of GDP.[3] The decline in trade and currency prices will affect both balances of payments and current accounts.

However, devaluations against the dollar of many Latin American currencies may offset some of the losses on exports, as this lowers the relative price of products from the region. In the six months to the end of 2008, the Brazilian real dropped by 45%, the Mexican peso by 35%, and the Argentine peso by 14%. The devaluations were in part the consequence of the strengthening of the US currency with respect to the most important currencies of the world, but also the result of a decline in the worldwide demand for Latin American exports and strong pressures on the financial markets of the region.

Remittances have become a major channel of income for many Latin American countries over the last fifteen years. Though the overall merits of increased mobility of large numbers of workers to jobs in industrialised countries are questionable, the impact of the consequent remittances to their home countries has been substantial. Mexico is among the largest recipients of remittances in the world and in Honduras remittances amount to 25% of GDP. In 2008 some USD 70 billion of remittances went to all of Latin America.[4] These flows have been relatively stable, and have acted as a countercyclical force in the receiving countries. Yet they are highly sensitive to economic conditions in the countries of origin. Worldwide, and for the first time in a quarter century, remittances started to fall in 2008. The prospects for 2009 are equally grim with adverse consequences for the purchasing power of many millions of households in Latin America.

Foreign direct investment (FDI) has become increasingly important in Latin America over the last decades, but is also set to decline. The inflow of FDI to Latin America has risen from USD 35 billion in 1980 to USD 481 billion in 2000 and USD 909 billion in 2006. With this, Latin America has also increased its total share of global FDI from 6 to 8 %.[5]

By early 2008 capital flows to developing countries had already started to slow down, and these flows fell sharply in the second half of the year reflecting the financial crisis. In the end, cumulative flows for the year were only about half of those registered in 2007, with sharp declines in Latin America. The decline is projected to continue in 2009, with the Institute of International Finance estimating that net flows for Latin America will drop by 75% from their 2007 peak.[6]

Finally, as financial markets remain volatile there is considerable uncertainty about the capacity of Latin American countries to renew their debt. The perceived risk of investments has resulted in a sharp increase in risk premiums, with particularly marked increases for Argentina, Ecuador and Venezuela. Only greater access to official and multilateral financing will probably offset this situation. Hence, after a period when the Latin American governments and businesses thought they would not have to depend on financing from the international financial institutions, there may be a need to revise this approach.

By the end January 2009, global fiscal stimulus to overcome the crisis amounted to almost USD 1 trillion for 2008 and 2009 combined, with a further USD 650 billion in 2010. Of these amounts, the major portion – more than four-fifths – had been undertaken by advanced economies. In Latin America, the two countries that have announced the largest packages as compared to GDP are Chile, with 2.2%, and Peru, with 2.5%. Both countries have low levels of debt, and in the case of Chile, the authorities have been building a successful stabilisation fund. All other countries have announced packages amounting to about one percent of GDP – e.g. Argentina 1.2%, Brazil 1.0% and Mexico 1.1% - which is considered to be about the maximum they can afford. In the end, most Latin American countries will have to rely on the effect of the stimulus packages of the larger economies, in addition to the effect of their own actions.[7]

Comparisons with the 1930s and lessons other from history

Almost three months into 2009, no one disputes that the present crisis is the worst financial and economic crisis the world has seen since the Great Depression of the 1930s. But it is not yet quite as bad. And it hopefully won't get as bad as then. From 1929 to 1933, 2,500 banks closed in the US and credit provided by banks contracted by one third. The stock market lost 75% of its value, GDP dropped dramatically, and unemployment rose to more than 25%. Within a couple of years it spread to other countries, and at the end the consequence was deep recessions worldwide. In the UK unemployment more than doubled to 20% and in Germany it reached 30%. Latin America was also severely hit, particularly Chile, Peru and Bolivia, not least because of increasing economic links with the US in the decades leading up to the crisis.

The similarities between the crisis in the 1930s and the one today are clear. They are both financial in nature, first crippled banks and then affected the real economy. They both erupted in the US and then spread to the rest of the world. And they are both based on some degree of imbalances in the global economy as well as between capital and labour in national economies.

But there are also marked differences between then and now, which should mean that today's crisis will be less deep and not continue for as long as then. With the help of governments, bank closures have not reached the same level and losses on deposits as well as other claims on banks have been minimal. Deflation was much stronger then – around 5% per year for several years – than what we can expect today. International trade dropped very steeply and was further limited by a rise in tariffs, which again is unexpected today. And there was very limited international cooperation then, with the US acting on its own and Europe divided and too weak to act. Today, international cooperation – with the G20 meeting already in November 2008 and again in April 2009 – has been much swifter, and appears to be both genuine and determined.

Many of the lessons from the Great Depression seem to have been learned – most importantly, to act early, aggressively and comprehensively. The Great Depression became as severe as it did because policy makers followed orthodox policies that allowed credit to shrink, banks to collapse, and the crisis to feed on itself for the first four years after the initial stock market crash. Excessive protectionism and beggar-thy-neighbour policies further allowed the crisis to persist and to deepen the meltdown of the real economy.

In the same way, many things have been learned from the 1990's crises in Japan and Sweden. In Japan, the collapse of house and equity price-bubbles, and the subsequent effect on banks, corporations and the wider economy, was allowed to go unaddressed for several years, contributing to a decade of weak growth. In Sweden on the other hand, the government intervened quickly to save its banks, but without just bailing them out. Rather than merely taking over bad debt, it had the banks accept their losses and then moved in as a new owner with fresh capital. This stabilised the Swedish banks and meant that the taxpayers were left without undue bills from the rescue plans.

Another thing that history has shown is the disastrous effects of falling wages in a crisis. In the 1930s, it was falling wages that sustained and extended the deflationary pressures as well as removed the floor in domestic demand. And it was the subsequent fall in income, living standards and everything related to it, that lead to fascism and nazism in the following years. Whether that has been learned, however, still remains uncertain. The present crisis is putting pressure on wages in most part of the world, and a real commitment from governments to stopping this downward spiral on workers income has not yet been seen.

The immediate and root causes

There should be not doubt that the present crisis is multifaceted and has a multitude of causes. Not just one phenomenon can be drawn out to explain how and why it happened. But there are certainly a set of triggers that deserve attention. On one hand, these have been much researched and described over the last half a year. On the other, to explain them and their dynamics fully deserves much more attention that I can give them here. Therefore, I will only mention these immediate causes briefly and then focus in larger part on the root causes of the crisis.

In short, the crisis has been caused by both deregulation of financial markets and the innovation of a range of new financial products as well as global imbalances and debt-driven economic growth. Throughout the last three decades, financial markets were liberalised and the financial sector deregulated at a stunning pace. Commercial and investment banks were allowed to merge their activities, with the dominance of the culture of the investment banks in the entire banking system as the result. Banks were also given the green light to increase their leverage – i.e. their debt-to-capital ratios – and moved away from traditional banking, where loans are balanced with deposits. With the advent of a range of new financial products and practices – such as credit default swaps and other derivatives, as well as so-called securitisation, where banks resell all or the majority of the loans they initiate to other actors – bankers became alchemists. They made huge profits from slicing up and moving around enormous amounts of money from one place to another. And they were given incentive structures that motivated them to make high returns tomorrow with no concern of the profitability of the transactions the day after again.

Concurrently, liquidity of money flooded the system. Interests were kept very low in large parts of the world and helped debt levels rise to a stage of inflated bubbles. Trade surpluses in countries like China, in part based on an undervalued currency, coupled with a continuous strong demand for dollars made the US economy expand with foreign debt as a seemingly free fuel. Tax cuts for the rich were regarded as the modern day equivalent of leeches, applied by George W. Bush every time the economy needed a new push, and lead to further financial speculation. Debt was everywhere while the risk of defaults was underestimated by rating agencies, whose business was based on serious conflicts of interest.

For years the global economy boomed. Global GDP rose at an average rate not seen since the early 1970s, most of this attributable to strong growth in emerging and developing economies. Inflation was generally contained in spite of a surge in commodity prices like oil and minerals. Asset prices skyrocketed without perceptible limits. Economists, corporate executives, journalists and policy-makers were talking of a new economic order, where growth could continue without the risks and constraints of the past. The world was in a new era.

But then again, as we have witnessed as of late, it wasn't. What was new, however, and as I am arguing are the root causes of the crisis, was the role finance played in our economies as well as a new balance between labour and capital. In the decades leading up to this crisis, the importance and dominance of finance grew in both our national economies and in the business sphere. Simultaneously, workers lost bargaining power vis-à-vis employers, wages stagnated in many parts of the world, inequality rose, and capital took up a still larger part of national income.

Financialisation

The most important background to the current crisis is the fact that in the decades up until the crisis, the dominance of the finance industry in the total sum of economic activity grew considerably. Increasingly, financial markets determined the state of the overall economy while financial demands dictated company behaviour. Developments in interest rates and stock prices increasingly shaped economic cycles and financial concerns. And those who voiced them became ever more influential in setting corporate strategies. In short, financial activities gained predominance over the production of goods and services.

This process occurred through changes in various parts of the economy. At the company level, it was linked to the 'shareholder value' approach to corporate governance, the model that gained momentum in the US and the UK from the 1980s on. It encourages financialisation of the company by maintaining that the purpose of its existence is to maximise the value of its shares rather than its long-term profits. It sees the company as a bundle of assets that generate different returns on investments, and believes that its purpose is to increase profits in the short-term by manipulating such assets through mergers, acquisitions and the like. Different financial ploys, such as share buy-backs, are used to increase the price of company shares. In short, it means that companies devote more and more resources to financial activity at the expense of their core activities.

The importance of the various aspects of finance grew substantially together with financialisation. In the US, between 1979 and 2005, the contribution of the finance, insurance and real estate sector to GDP rose from 15.2% to 20.4%. Employment as a share of total private sector employment in these sectors rose from 6.6% to 7.3%. The changes were even more marked in the division of domestic corporate profits between the financial and non-financial sector. Thus, between 1973 and 2005 total profits rose from 7.3% to 10.3% of GDP. The financial sectors share of profits has risen especially strongly. Hence, in 1973 financial sector corporate profits made up 25.7% of non-financial corporate profits, but had by 2000 risen to 49.7%. Only in the last couple of years, when there was a strong rise in non-financial corporate profits, they fell back a bit, standing at 43.2 % in 2005.[8]

Similarly, the value of financial assets has been growing much quicker than GDP for some time now. Only between 2003 and 2007, the ratio of financial assets to GDP worldwide grew by 45%, so that they stood at 490% by the end of 2007. This happen in Latin America as well, though here the rise in the ratio was a bit modest, from 135% to 176%, representing an increase of 30%.[9]

In the process of financialisation, the financial sector took on an increasing amount of debt. Hence, in the US, the aggregate debt of the financial sector rocketed from 22% of GDP in 1981 to 117% by the third quarter of 2008. In the UK, where financial activity has played an even stronger role in the economy, the gross debt of the financial sector reached almost 250% of GDP before the crisis.[10]

Distribution and income inequality

In the decades before the crisis, pressures on workers intensified in most parts of the world. In many countries trade unions were weakened and had less favourable conditions for organising and bargaining. Increased competition for export markets and foreign direct investment, as well as the threat of outsourcing, added to the strains. When the amount of available workers in the world effectively doubled around the turn of the century, capital's upper hand in relation to labour was solidified. The result has been stagnating wages, a smaller share of income going to workers, and rising inequality in earnings.

Though wages stagnated and declined, economic growth was often strong and corporate profits soared. In all of the G7 economies – that is the US, Japan, Germany, the UK, France, Canada and Italy – the share of profits in national income has been peaking. Before the crisis, after tax profits in the US were at their highest as a proportion of GDP for 75 years, and corporate profits in the Euro area and Japan were also around their highest for at least 25 years.[11]

Labour's share of economic activity and national income, on the other hand, had hardly ever been lower. In the US, the share of national income going to wages and workers in 2006 was at its lowest level in 75 years. The developments were similar in many other rich countries – for example Germany from the mid-1990s and until today.[12] But it was not only in the advanced economies that labour's part of the national income was declining. In a majority of poor countries, labour's share in national income has been eroding since 1960 and until today, with a somewhat more quickly decline since 1993.[13]

As a consequence of these developments, workers in many countries, not least the US, have had to borrow to be able to spend. Indeed, it has been noted that the American working class has been on the greatest binge of borrowing in the history of any working class in any country at any time.[14] In general, changes in the distribution of national income led to a state of under-consumption, which could only be offset by the expansion of debt.

Warnings ignored

At present, most policy-makers, governments and their international organisations are busy washing away their sins. The majority of them contend that the current crisis came without warnings and that no one could have predicted it. In the US, the outset of the crisis, they blame a variety of idiosyncrasies of banks, corporate executives and those who were supposed to supervise them. In the rest of the world, they point to the US and insist that the causes of the crisis are all external and that its consequences are inevitable in the age of globalisation.

But there were warnings. They weren't many, but they were there. In the years before the crisis erupted, particularly the international trade union movement voiced concern over the increasing reliance of debt in the corporate world. It was the main message of a report that I drafted for the International Trade Union Confederation (ITUC) in the Spring of 2007, and which was released a couple of months prior to the sub-prime meltdown. The report was on private equity and hedge funds, considered the most visible protagonists of financialisation. But the warnings were more general:

"Financial crashes and company bankruptcies are not far away. They could be triggered by individual company or fund problems, mass defaults of company bonds, inflation or rising interest rates. Indeed, history has already shown that when leverage plays a role in strong market developments it often ends badly. If financial regulators fail to act on the risks, if strong credit assessments are not performed all around, and if companies fall short in stress-testing their leverage, history will once again prove that it repeats itself."[15]

On the excessive level of leverage, the report specifically noted that such use of debt "…creates more volatility in markets and poses widespread systemic risks and concerns. Excess liquidity might just be moving from market to market, first affecting real estate – where major corrections have already taken place, in the US for example – and then companies (or 'equities', as they are generally called in investment jargon). The cost of borrowing capital will eventually adjust upwards. When this happens asset prices will have to move down and most leveraged private equity players will be in trouble."[16]

The report acknowledged that most financial actors looked stronger than ever, but insisted that this was only when only viewed on the surface. Hence, it put that "…though this leverage boom presently appears unstoppable, it may come to an end much earlier than expected. Its apparent strength and attraction may, indeed, ultimately become its weakness.” The report was clear on the inflated nature of asset prices, yet noted that both a soft and hard landing could be possible: “… before the bubble bursts by itself, it might also be popped by regulators.”[17]

However, not only the trade union movement voiced their concern. And as the sub-prime crisis was already unfolding, several new warnings of larger scale financial collapse surfaced – yet without any regulars seriously reacting. Perhaps the most precise prophecy came from economics professor Nouriel Roubini. In February 2008 his look into the future read as the following:

“…there is now a rising probability of a ‘catastrophic’ financial and economic outcome, i.e. a vicious circle where a deep recession makes the financial losses more severe and where, in turn, large and growing financial losses and a financial meltdown make the recession even more severe. (…) Such a scenario – however extreme – has a rising and significant probability of occurring. (…) A near global economic recession will ensue as the financial and credit losses and the credit crunch spread around the world. Panic, fire sales, cascading fall in asset prices will exacerbate the financial and real economic distress as a number of large and systemically important financial institutions go bankrupt. (…) In this meltdown scenario US and global financial markets will experience their most severe crisis in the last quarter of a century.”[18]

But no one seemed to listen – neither to the warnings coming from labour nor to the ones stemming from academia. Before the sub-prime crisis they were disregarded as ideological. And once in that crisis, they were discounted on the belief that markets would eventually return to equilibriums. Indeed, in the spring of 2008 – months before the exacerbation of the crisis – the IMF, the US’ Federal Reserve and the Bank of England spread the message that the worst part of the credit crunch could very well be over.

This was the height on an ideological era, and its champions were not yet ready to question their faith in all-out liberalisation and deregulation. They were sceptical that it had any flaws and believed that market mispricing, which was what they regarded the credit crunch as, would only be temporary. Indeed, they were confident that the tide would quickly turn and the situation be back to ‘normal’: high growth and the financial sector in the economic driving seat. This could only be the case because they for three decades had told each other that this was how the world worked.

Changing paradigm?

Today this belief is increasingly being questioned. The pendulum is swinging. The mainstream may just be turning from right to left. Some of the most pro-market advocates have voiced concern over the lack of self-regulation of markets and argued for increased government oversight. In economic policy-making, the old virtues of Keynes and mixed-economies are coming back in style. Indeed, currently a classical conservative like French President Nicolas Sarkozy can be quoted daily for saying things like “Either we re-found capitalism or we destroy it”[19]

Even some of the institutions most closely linked to capitalist globalisation are questioning market beliefs and admitting that they made mistakes. Hence, the IMF recently blamed policymakers for “a general belief in light-touch regulation based on the assumption that financial market discipline would root out reckless behavior and that financial innovation was spreading risk, not concentrating it. Both these assumptions proved wrong, and the result was a massive asset price bubble…” In relation to warnings of a crisis, it noted that “despite the growing threat, the IMF and other institutions failed to send a strong wakeup call to policymakers and achieve a collaborative policy response”[20]

There are other signs of a change too. As countries are dealing with the crisis, more and more turn to demand-side policies, and use fiscal stimulus to reignite their economies. The most mainstream and orthodox actors on structural reforms – like the IMF and the OECD, who have long argued for small states and austerity in public spending – are now putting forward massive public investment as the favoured policy response to the economic part of the crisis.[21]

In many places money is already being put where the mouth is. This entails a new balance between private and public parts of national economies. Thus, the amount of money spent on crisis management in 2008 alone equal some of the privatisation process that occurred over the previous decades. By December 2008, the total value of the renationalisations of banks and insurance companies in the US, the UK and the rest of Europe was approximately equivalent to reversing about half of all the privatisations in the entire world over the last 30 years. And the renationalisation of the insurance company AIG was by itself equivalent to reversing all the privatisations that have taken place in the former communist states of Central and Eastern Europe since end of the cold war.[22]

The era of liberalisation and deregulation that persisted until the present crisis was initiated around the time when Ronald Reagan in his first Inaugural Address as President of the US stated that “government is not the solution to our problem; government is the problem.” Today, no one seems to be arguing this. Government has indeed been the solution – even for the most conservative bankers and financiers. The question, however, is if government continues to hold the reign as the solution? And hence, if the paradigm is indeed changing?

While the IMF has generally been strong in advising rich countries to expand their public spending and thus to pursue counter-cyclical policies, poor countries who borrow from the IMF are being told to save, to cut costs, to enact pro-cyclical policies, and are hence not getting any more flexibility in fiscal policy than what they used to. So if there is a new policy model, it may only be for the already affluent. Similarly, discussions with the OECD give the impression that its change in policy orientation is only temporary. Once the economy has been stabilised and growth restored, governments should return to the well known policies of structural reform that prescribe lower taxes, less state-intervention and more liberal labour markets.

And there are other forces slowing and trying to reverse the pendulum. Already, conservatives are arguing that this crisis wasn’t caused by the lack of regulation and government intervention, but precisely by it. The US Federal Reserve failed when it kept money too cheap for too long, thus temporarily fooling the market, they say. And it was government agencies that insisted on lending money to people who couldn’t afford the houses they were buying, they argue. Not markets themselves, but government interference created the problems, they stubbornly hold.

And one can be sure that once the economy is back in shape, conservatives and neoliberals – with an even stronger voice – will list twenty things that governments did over the last decades, which indeed they did, and draw a line from those things to the crisis that will then have just passed. From this they will conclude that it was just these actions that created the present disaster. And they will argue that the future will only be benign if it sees less regulation and government intervention.

So are we in the midst of a change of paradigm? Or is this merely a period of minor deviations? The definitive answer can still not be given. But the labour movement and progressives in general surely have a great task in ensuring that it is the first, not the latter, that is the case.

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[3] World Bank, Swimming Against the Tide: How Developing Countries are coping with the Global Crisis, March 2009

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[5] ADB, 'Global financial turmoil and Emerging Market Economies: Major contagion and a shocking loss of wealth?', March 2009

[6] ADB, 'Global financial turmoil and Emerging Market Economies: Major contagion and a shocking loss of wealth?', March 2009

[7] ADB, 'Global financial turmoil and Emerging Market Economies: Major contagion and a shocking loss of wealth?', March 2009

[8] Thomas I. Palley, 'Financialisation: What It Is and Why It Matters', December 2007

[9]ADB, 'Global financial turmoil and Emerging Market Economies: Major contagion and a shocking loss of wealth?', March 2009. Note: These assets include collateralized financial instruments (mortgage backed securities or MBS, and Collateralized debt obligations or CDOs). They do not include the complex set of financial derivatives like CDS (Credit Default Swaps) that further multiplied the size of the financial market.

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