On the Implications of the Global Financial Crisis: Some Thoughts about the Past and the Future

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The events of mid-October 2008 have shown with absolute clarity that we are at the beginning of a world economic crisis. From each corner of the world, we now hear near daily news reports about wild oscillations—mostly downward—in stock markets, as well as major banks, insurance companies, and various financial institutions going bankrupt. Governments are desperately intervening with massive infusions of cash, trying to stop the avalanche. They are “injecting capital” into financial markets, which means buying bad debt from banks or buying the failing institutions themselves.

Though the world nationalization is usually avoided by politicians, it is clear that that is exactly what occurred with Fannie Mae, Freddy Mac, and AIG in the United States. Extensive nationalizations in the bank sector in the United Kingdom followed those in the United States. The U.S. federal government subsequently intervened in the largest nine banks by acquiring large shares of them, totalling about US$125 billion. In other European countries, Russia, Japan, and South Korea, governments are also intervening to try to prevent a financial meltdown. Small—and previously rich—Iceland, with just over 300,000 people, sadly became infamous when the value held by its banks suddenly evaporated. Icelandic financial institutions had been investing heavily in the global economy in recent years.

Signs of a severe downturn of economic activity were evident in many countries before the financial crisis hit. For instance, unemployment has been increasing throughout 2008 in most European countries. Retail sales, orders for production, and prices of commodities (iron, wheat, coal, oil, etc.) are falling, while foreclosures and business failures are rising. In the U.S., where retirement income is largely dependent on individual savings and pension funds that invest heavily in the stock market, many people have seen their retirement accounts lose a substantial portion of their value.

Despite enormous public opposition, the $700 billion financial bailout that was proposed in September by U.S. Treasury Secretary Henry Paulson and U.S. Federal Reserve Chairman Ben Bernanke was eventually approved by the U.S. Congress. The several-hundred-page plan that was passed by the Congress differs from the original three-page plan in that more opportunity is established for the federal government to “take equity” in the financial institutions that are “helped.” This means taxpayer money is being used to buy property shares in the distressed institutions, instead of, as in the original plan, just buying the banks’ bad debt. That the government is acquiring “equity” in financial corporations in exchange for the massive infusions of public money opens a door to the possibility that the taxpayers’ money may “eventually” be recovered. Despite the fact that that door is just theoretical, very small, and very unlikely to open in the future, this claim provided the necessary leverage for lawmakers of both parties to vote in favor of the bill.

Every version of the bailout bill transfers massive quantities of taxpayer money to the
financial institutions owned by the superrich and constitutes a massive economic intervention by the government. It goes therefore against the grain of the free-market principle that is the foundation of mainstream economics. Republicans have been propagating free-market fundamentalism as the essential truth for decades (the so-called “American dream” and “Joe the Plumber” are popular versions of it), and Democrats usually followed suit—with some minor objections. In mid-October, *The New York Times* buried on page 25 the news that the amount of taxpayer money committed by the ongoing interventions of the U.S. government will not be the original $700 billion—that is, $700,000 million—but rather three times that quantity—$2.25 trillion, or, to put it in numbers that have more concrete meaning, $2.25 million million. Do we hear any outcry about it from our political leaders? No. Their response to the escalating global economic meltdown is Joe the Plumber and whether tax cuts will be just for the bottom 95 percent of Americans (Obama) or, as McCain promises, for *all* Americans (how inclusive!). How deceptive, misleading, and irresponsible can politicians can be?

Just by looking at the numbers, all the panicked activity of governments around the world is quite unlikely to be able to stop the crisis in financial markets. It is estimated that more than $500 trillion moves around in world financial markets each year, while the entire annual volume of the U.S. economy—the U.S. gross domestic product, or GDP—is just over $13 trillion. The U.S. federal budget—what the government spends per year—is about $3 trillion. The figures thus far cited for worldwide government interventions amount to just a few trillion dollars. The exponential growth of world finance over the last three decades, which was strongly fueled by derivatives, has created a humongous monster that, as in the story of the sorcerer’s apprentice, is now impossible to bring under control.

Odds are that the real economy—i.e., the production of useful things like food, washing machines, or education—will continue contracting in the next months, and judging by the structural disturbances, it is quite likely that we will see a deep and lasting economic depression. In spite of government interventions, it is likely that worldwide, we will see many companies fail in the next months. In the non-financial sector, frozen credit markets and—more importantly—reduced purchasing power of both consumers and businesses will lead many small, medium, and big companies to fail, causing massive numbers of jobs to be lost, steep declines in tax revenues, and a resulting inability of local, regional, and national governments to provide services and help to those in need. It is unclear to what extent governments are overcommitting their ability to insure, and thus guarantee bank deposits, so that in spite of all the promises, bank savings could be lost, too. It is also quite possible that we could experience a dramatic loss in the purchasing power of money. Given the lack of connection of present money with any commodity with real value (gold) and the recent actions of governments to balloon the already high levels of government debt, hyperinflation as occurred in Latin America in the 1980s or in Germany after World War I is a real possibility in the near future.

Such economic destabilization could create a very ugly societal scenario throughout Western societies. Economic crises provoke massive political realignments, because they push people to take actions to defend their interests. In these situations, traditional opinion leaders are often ignored, because people are angry at those who were at the rudder preaching about a bright future when the ship was heading straight into the maelstrom. People pay increasing attention to those with different messages who provide more plausible explanations for what is happening. Unfortunately, such situations also increase the attractiveness of demagogues, who are often good at convincing people that the best way to solve problems is just to trust in them, because they know better.
In the period of political and economic turmoil between the two World Wars, Europe saw the rise of two skillful demagogues, Mussolini and Hitler. Both had a rhetoric of socialism and praised the common man, but as soon as they got into power, they crushed all democratic rights, political parties, workers’ unions, and social organizations. Both verbally trashed the rich and the “plutocrats,” but once in power, they helped corporations with government money and enormous contracts for public works projects and weapons manufacturing. Using a potent combination of patriotic harangue and hateful speech against Jews, communists, and other “degenerate” groups along with the support of German corporations, which were afraid of losing their economic power in the crisis, Hitler was able to deceive many Germans and gain political power. Once there, state-financed weapons manufacturing and public works created economic activity and reduced mass unemployment to almost zero in just a few months. Most Germans were grateful to the savior, so it was easy to get them to acquiesce to domestic repression and an aggressive foreign policy. The rest of the story is known. Twelve years after the Nazis took power, Germany and its allies, Italy and Japan, were militarily destroyed, and millions had been killed in World War II.

Unlike old societies, which were strongly dependent on natural phenomena and thus vulnerable to severe famines as a result of a bad harvest or a locust invasion, the modern economies of the Western world have the capability of producing food with much less human labor and warehousing it, which makes them relatively immune to these kinds of events. Nobody has heard about famines related to bad harvests during the 20th century in Europe or North America. However, many people went hungry in European countries during both World Wars, when human activity was channelled into destructive activities, redirecting productive resources into making tanks and bombs instead of bread and washing machines. During the Great Depression, many people were also hungry, not for the lack of food, but for the lack of money to buy food, and the lack of a job to produce an income. If increases in general mortality rates during the Great Depression did not occur in any Western country, it was because income support and direct help to those in need were sufficient to prevent starvation, though they did not prevent many people from falling into extreme poverty.

In the United States, numerous social policies were set in place during the 1930s to provide protection against joblessness, disability, and the ailments of advanced age. Despite the sad reality that many of these policies were very discriminatory—for instance favoring men over women and whites over blacks and latinos—they were the core of the U.S. welfare state, which the right-wing neoliberal agenda has over the last 40 years worked relentlessly to destroy, promising instead that everybody could get rich by putting their money and trust in the stock market. Whether the social policies of the 1930s were enacted mainly because of the populist and friendly character of Franklin Delano Roosevelt, or rather as concessions to major popular unrest and a fearful American elite scared of the country taking a socialist turn is a historical issue that historians and political scientists have long argued.

Present developments with the massive government interventions to support financial capital markets are revealing clearly that governments, banks, and big corporations are acting together as if they were the same entity. Taxpayer money has been generously ladled into American banks—the quantity exposed in this infusion of taxpayer funds amounts to $6,000 per U.S. citizen—and that without having even granted the public voting rights on the boards of the banks. Still, pundits tell us we must not worry—if we are lucky, the money will be recovered!
Only popular action may prevent this world crisis from being another occasion for the elites to appropriate the wealth of society. Sadly, so far there are only reasons to be pessimistic. Under the pretense for the need for urgent action to “save us all,” huge sums of taxpayers’ money in numerous countries are being quickly whisked away into private hands, and so far, the public is just passively watching the spoilage.

Every economic crisis in a market economy has specific causes and triggering factors, but a common factor to all of them is a drop in business profitability. Indeed, a few months before, while the present financial turmoil was incubating, it was reported that profits earned in the United States by American companies had dropped 18 percent from their peak of $1.27 trillion in the third quarter of 2006 to $1.04 trillion in the first-quarter of 2008.

The recovery from a crisis implies the recovery of profitability to former levels. Once an economic downturn is full-blown, failed companies provide good opportunities for investment, while layoffs increase the levels of unemployment, forcing workers to accept lower wages. All that creates better opportunities for business, at the cost of mounting social distress. But even that is sometimes insufficient. In the United States, the long-lasting depression of the 1930s only ended when World War II started providing a strong stimulus for the economy. The destruction caused by that war and the tens of million killed by it were presented as the price that needed to be paid to defeat evil in a heroic, universal fight against fascism and for democracy. However, in one of the two superpowers that emerged victorious in 1945, there was massive repression of the people. In the other, racism was rampant, and African-Americans were treated as pariahs.

Some progress has been made in these areas, so perhaps we can hope that this time humanity will be able to do better. U.S. Republican presidential candidate John McCain says that you need to speak softly and carry a big stick. Rather, it is time for humanity to take the sticks out of the hands of aggressive people, stop money and profit from being the Golden Calf that society worships, and embark in a collective construction of the future. Only then will we be able to avoid the destruction that we are seeing unfold today.