One (or two) years on - they have learned nothing

Posted by Jerome a Paris on October 12, 2009 - 8:25am in The Oil Drum: Europe
Topic: Economics/Finance
Tags: regulation [list all tags]

Just over one year after it became impossible to deny that the financial crisis that had started in 2006/2007 was a major, systemic event, it is rather depressing to see that nothing has really changed and, to the contrary, if anything has, it is for the worse.

The most striking item, of course, is the continued dominance of politicians by bankers. Banks are universally seen - including by bankers - as being at the heart of the problem, and having created the crisis through reckless behavior and worse. And yet, after having being bailed out at a staggering cost, in a highly asymmetrical way (the losses were socialised, but not the banks), not only have they managed to eliminate the likelihood of any meaningful regulatory change, but more importantly they have managed to maintain the fiction that finance was the reason for earlier prosperity and should thus be protected as a source of *future* prosperity. The crash has not made anyone question the quality (or reality) of the previous boom, but rather made them wistful for these times. Thus, the dominance of the finance sector on the economy and the airwaves has not changed one bit: we still worry about the stock market, it's still financial analysts and economists that drive the public debate, we're still talking about "reforms" of entitlements or the labor market as if these were the main problem today, and public policy largely avoids the big looming issues of resource depletion and climate change.

To extend on this a bit, here are a few items worth noting:

- there's very little discussion of the fact that this is an *income* crisis namely, stagnation/lack of income, which was dissimulated for a long time by increased access to debt. All the endless debating about replacing private debt by public debt and whether that's a good thing or a sustainable one ignore the underlying problem: middle and lower class wages & incomes have been squeezed and need to be supported. Instead, we get savage budget cuts in social spending, ie in the very programmes that supplement or complement most people's incomes, and yet more talk about making the labor market more "flexible" (which only ever means pushing wages down). Public spending in collective infrastructure that would support living standards (including energy-saving plans such as support to home efficiency, or public transport), backed by real income (ie taxes on those who do not spend all their wages) is not seen as something necessary like the bank bailouts were;
- there's been very little talk of the profound underlying responsibility of the financial world in that drive to reduce the cost of labour. This is usually presented as an inevitable consequence of globalisation, when in fact it's been a clear *policy choice* to focus policy priorities on improving returns on capital (at the expense of everybody else), and to take decisions that justified these choices. For instance, the permanent push to make pensions market-based rather than government-run: this creates new markets for the finance industry and, at the same time, helps justify return on capital requirements as something good for everybody's pensions; stock market performance and short term returns of investment managers then become key numbers for everybody and further drive the focus on short term profitability;
- the massive call upon public resources, and the apparent "success" of bailout/stimulus plans

(ie governments succeeded where the private market failed), as touted by the markets and politicians, has not lead to a real change of mood about government being a solution rather than a problem. Consistency is not the hallmark of our times. Already the talk is about too-invasive regulation, and unhealthy public debt burdens, as if these had been caused by reckless civil servants. The most obvious point is that higher taxes to pay for government saving the day are still seen everywhere as inconceivable or inacceptable. Just like the War on Terror did not apparently require any financial effort, the Big Bank Bailout cannot be allowed to touch upon taxpayers - or banks, which are too-big-to-fail*er* than before.

- the oil price increases prior to the crash are now dismissed as aberrations caused by speculators and not a signal of anything deeper happening; similarly climate change worries are often dismissed by Serious People as a "luxury" in today's tough times. As a result, we're doing even less than we could on these problems - and so much less than we should. Oh sure, there's a nice bit of spending on green technologies in the various stimulus plans, but it's still dwarfed by help to traditional sectors of the economy (ie it's not really a game changer yet) and it's nothing compared to what we know *can* be done. More importantly, it's still seen as a sideshow, and more of a necessary PR exercise than actual policy; more generally, the focus on short term needs eclipses any long term thinking and planning; the past blanket discredit thrown upon government prevents it from fulfilling that natural role (and brings about a slow decay of infrastructure, generally);
- in that context, the impact of deregulation on energy markets, which encourages investment by private sector (at private sector cost of capital) rather than by the public sector (at discount rates close to long term sovereign debt cost) is never discussed. That means that energy spending is focusing, structurally, on investment-light but fuel-rich technologies, as it is easier to keep such investment profitable in the face of volatile prices even if it's not the cheapest technology. Thus we stay on our oil (and gas)-dependent trajectory through investment that can tie us in for decades. Additionally, private decisions on infrastructure generally lead to boom-and-bust cycles as supply reacts in exaggerated fashion to short term demand and price signals. But the financial world get to trade, hedge and finance to its heart, and apparently this is all that matters;
- throughout, progressive ideas and parties have been discredited - either by having Serious People call the bailout of the financial world and other current regressive policies "socialism," blaming the continuing crisis on Big Government while preventing actual public intervention where it would matter (public investment, increased transfers to the poor and unemployed, better and/or more universal public health care, etc) - followed by the knockout blow: claiming very loudly that the crisis somehow discredits alternatives to unfettered markets;
- behind all this, of course, is the agenda of large corporations - old industry incumbents, financial behemoths, not to mention the healthcare insurance juggernaut in the US - and their shareholders, and the twin overridding imperatives of return on equity and "competitive" management pay. They lobby, they run the debate and they outright buy off politicians. The grip of money over politics and policy has, if anything, tightened. But it's not seen as related to the crisis in any way - at least not by the Serious People (ie those that buy Serious People or are bought by them)

We need policies that actively promote (i) increasing incomes for the lower and middle classes, (ii) public investment (in particular on energy and healthcare) paid for by increased taxes, (iii) cutting down corporates (in particular, banks) to size. We obviously won't get any of these until the influence of money on politicians has been cut massively.

The past crisis was obviously not sufficient to shake the current system; if anything, the grip has been tightened. Pain for the masses does not matter if it has no impact on the political process; the past year suggests that the corporatists have been successful at defusing public anger and pointing it away from the real culprits; in many countries, the left is split between those that have been compromised too much within the system and those that are too seen as too shrill and neither can provide a credible alternative.

All this points, unfortunately, to a bigger crisis soon.