Simply Collateral Damage?

The Financial Crisis and the Developing Countries

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List of Abbreviations

DAC - OECD Development Assistance Committee
FAO - Food and Agriculture Organization of the United Nations
FDI - Foreign Direct Investment
FED - Federal Reserve System
FTT - Financial Transaction Tax
G 20 - Group of Twenty
GATS - General Agreement on Trade in Services
GDP - Gross Domestic Product
GNI - Gross National Income
HIPC - Highly Indebted Poor Countries
HNWI - High Net Worth Individuals
ILO - International Labour Organisation
IMF - International Monetary Fund
MDGs - Millennium Development Goals
ODA - Official Development Assistance
OECD - Organisation for Economic Co-operation and Development
UNCTAD - United Nations Conference on Trade and Development
UNO - United Nations Organisation
USD - US Dollar
WTO - World Trade Organisation
1. Introduction

The financial and economic crisis which has been shaking the global economy since 2008 is the most severe of its kind since the Great Depression of 1929. It can only be compared in its historic impact with other large upheavals of the past two decades, such as the fall of the Berlin Wall and the terrorist attacks of September 11, 2001.

In contrast to other financial crises that erupted in the emerging economies since the 1990s - Mexico, Asia, Brazil, Russia, Argentina - it started in the centre of the global financial system, the US. It then spread to the other industrial countries and finally encompassed the whole globe. No country remained unaffected, even though the extent of the impact in each case was very different. Consequently this crisis is historically unique, for the first time the whole world was indeed immediately affected.

The crisis has caused worldwide losses amounting to about 3.4 trillion Euros according to estimates by the International Monetary Fund (IMF). That is more than the GDP of France and twice the GDP of Brazil (see Fig. 1).

Fig. 1: Unimaginable losses
Losses of banks and other financial players incurred by the crisis, as compared to the GDP of selected countries (in bill. USD)

At the time, mainstream politicians, economists and journalists attributed the causes of the frequent financial crises that erupted in the emerging economies in the 1990s and at the beginning of the 21st century, to the underdeveloped financial markets, weak supervision and corruption, together with crony capitalism. The international system and especially its centres on Wall Street, in the City of London and other large financial centres were assumed to be stable and efficient. Even after the G8 Summit in Heiligendamm, when the first signs of the Subprime Crisis in the US began to appear, the CEO of the Deutsche Bank, Ackermann, proclaimed: “The system’s overall capacity to absorb risks is increased by spreading the risks
more broadly in the financial system, so that they are no longer exclusively concentrated in
the banks“ (Ackermann 2007).

And even after the collapse of Lehman Brothers on September 15th, 2008, leading financial
politicians had not grasped the fact that this financial crisis was more than an interruption in
the allegedly inexorable rise of an economic model in which the financial markets appear to
be the centre and motor of an unstoppable accumulation of wealth. On September 25th, 2008,
Peer Steinbrück, then German Minister of Finance, declared in the German parliament
(Bundestag) that the financial crisis was „mainly a US problem." The German financial
system was „relatively robust" and there were no reason to expect such horror scenarios:
"The spreading of these sadistic-masochistic tendencies are a complete mystery to me"
(Spiegel Online 2008).

1.1. Financial Capitalism - A New System for Economic Activity

In the meantime, the crash has turned out to be the collapse of a system that started to emerge
with the end of the fixed exchange rates in 1973, and the subsequent liberalisation and
deregulation of the financial markets. These, together with so-called innovations caused the
development of incredible dynamics in the 1990s and in the first decade of the 21st century.
Consequently, the roots of the problem were created over three decades ago. The neo-liberal
mainstream calls this development since the 1970s financialization. Others, for instance
UNCTAD, describe it in the Keynesian tradition as the giant casino (UNCTAD 2009a: 60),
and still others refer to it as asset and wealth centred capitalism or financial market
capitalism or finance-driven capitalism (Bischoff 2009).

Whatever this new system is called, there is broad consensus that a new kind of economic
activity has emerged in the past thirty years, based on the financial markets. Until then, the
financial sector played a secondary and subordinate role in relation to the real economy. Its
task was to enable payment transactions and to provide credit to companies, households and
the state, whereas today the financial industry dominates the economies of the industrialized
countries. Thus, the real economy, production, trade and non-finance related services are now
being dominated by the financial sector. The original relationship – the financial sector as a
service provider for real economy – has been turned upside down. Moreover, the logic of the
financial markets, with its central maxim of maximum efficiency and maximum profit under
all circumstances and at all times, is being transferred in a multitude of ways and at an
increasing rate in manifold ways to the real sector (see Chapter 2.1).

This has created something that Germany's Federal President Köhler, in an appropriate
metaphor, called a monster. A monster that is causing enormous damage even as it is falling –
or precisely because it is falling.

The realisation that we are dealing with a new system of capitalism, is even shared by some
representatives of the political elite. In his speech at the World Economic Forum 2010 in
Davos, the French president said: „I want to very clearly state that the globalisation of
savings has created a world in which everything was given to financial capital and nothing to
labour, where the entrepreneur was secondary to the speculator, where the capital owner was
privileged above the employees, where the leverage – the whole world only talks about
‘leverage’ – has assumed irrational dimensions. All this created a capitalism in which it was
normal to gamble with money, preferably other people's money, to obtain money easily and
extremely fast, without any effort and often without creating wealth or generating employment
with these huge amounts of money“ (Sarkozy 2010).

It is this new system that has now collapsed, and the causes are systemic. That is, it would be
too simplistic to reduce this collapse to one cause, one single factor such as cheap money that
the Federal Reserve Bank pumped into the markets since 2001, the extremely risky Credit
Default Swaps or the global imbalances. All these factors surely play a role but finally it is the
unstable institutional structure of the financial system which lead to its collapse. If the Subprime Crisis in the US had not triggered the crisis, the crash would have been initiated in a different place sooner or later. The financial market capitalism that has emerged in the past thirty years is built on sand, with the trust in the belief that the market would be capable of self-reliant, sustainable development without political regulation. Measured by the criteria of stability, it is like a house of cards. No matter where you touch it, it must collapse at some point.

1.2. Blamelessly Caught Between Two Millstones - the South and the Crisis

The developing countries and emerging economies were not involved in the system of financial capitalism. Of course, the upper classes of course used the opportunities in the new system for additional profit but the economies of the poor countries were neither adequately integrated into the global financial system nor did they have the means to play in the giant gambling hall. They are not interesting enough for the large speculators in the North. The South already suffered liberalisation and deregulation on the financial markets in the debt crisis that broke out in 1984 when Brazil and Mexico declared insolvency. Even today, the group of about 40 Highly Indebted Poor Countries (HIPCs) has still not recovered, more than 25 years later. This shows that the consequences of a financial crisis can be suffered over a whole generation.

Even the emerging economies were hardly involved in the system. However, they were targeted by speculative business models from the North because of the effects of globalisation, i.e. as far as their financial markets had been liberalized and deregulated, for instance in Carry Trade (see Chapter 2.1.1, Box 1). China, the largest player among the emerging countries, did not liberalize its financial markets. India also still retained many restrictions and a number of other countries even reversed the level of openness to some extent as a result of their experience with the Asian Crisis and, for example, countries such as Malaysia even introduced capital controls.

Against this background, there was talk of a hypothesis even among heterodox economists of an uncoupling of emerging economies and developing countries until the Lehman bankruptcy. In Spring 2008, Akyüz, former UNCTAD chief economist, wrote: „However, for the first time in modern history, hopes seem to be largely pinned on developing countries, particularly in Asia, for sustaining stability and growth in the world economy“ (Akyüz 2008). The enormous growth rates that were achieved since 2003 in some countries in Africa, Asia and Latin America, which mainly were due to an export boom in commodities, seemed to be independent of developments on the financial markets. However, this assumption had to be an illusion, considering the numerous and close interdependencies in the globalized economy. Under the conditions of globalisation it is now impossible to put a crisis in one region under quarantine and protect the rest of the world from the crisis.

The main route taken by the infection that affected the emerging economies and developing countries was through the real economy, mainly trade. The decline in demand in the industrialized countries due to the crisis put an end to the export boom. Then the collapse of capital flows and the decline in foreign direct investment followed. There can be no talk of decoupling. The South has to suffer the consequences caused by others. Those that are worst affected are the already disadvantaged, the poor and the socially marginalized. The aim of the Millennium Development Goals (MDGs) to reduce poverty by half by 2015 – i.e. within only five years – which is already too unambitious, is unattainable.

For instance, in a global comparison, the number of HNWIs (High Net Worth Individuals = persons with liquid assets, i.e. excluding real estate, luxury goods, etc. of 1 million US-dollars and more) in Sub-Sahara-Africa has been increasing by the fastest rate in recent years (Merrill Lynch/Capgemini 2009).
The crisis is mainly hitting the poor developing countries in a situation where, because of the resources boom of recent years, hope had emerged that finally, after many lost decades, some substantial developing successes would appear and misery and poverty could be reversed. Even for the region of Sub-Saharan Africa with its extreme problems there seemed to be some perspective of amelioration due to growth rates of five to six percent. These hopes have now been shattered (see Chapter 2.3).

1.3. The Crisis Is Not Over
The history of the crisis is also a history of erroneous prognoses about its end. Not only did the mainstream initially fail to anticipate the crisis and completely underestimated it, or played it down for strategic reasons – but optimism was again spreading only a few weeks after the Lehman collapse. The surviving large speculators such as Goldman Sachs or the Deutsche Bank achieved incredible profits and paid their managers massive bonuses. However, when the Gulf emirate Dubai declared insolvency in November 2009, and Greece, a Euro zone country, came threateningly close to insolvency in February 2010, there was an increasing understanding that the crisis would be much longer and extend much further than many expected. This, by the way, was similar to the Great Depression. After Black Friday in 1929, things seemed to recover again until the situation deteriorated again in 1933. The crisis was not overcome in the US until 1939, a decade later.

The World bank now estimates it may also require up to ten years to recover from the consequences of the current crisis (World Bank 2010a: 5). That would mean a lost decade.

Even the immediate dangers facing the financial sector have not yet been averted. There are still toxic derivatives amounting to trillions on the books, while speculation is already causing bubbles again, for instance, recently with the Credit Default Swaps that were used to speculate against Greece and aggravated the country's financing problems.

Fig. 2: Debt explosion as a consequence of the crisis in the North
Development of public debt in selected countries (percentage of GNP)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2009</th>
<th>2010*</th>
<th>2014*</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>42,3</td>
<td>58,1</td>
<td>66,8</td>
<td>84,9</td>
</tr>
<tr>
<td>FRG</td>
<td>56,9</td>
<td>70,3</td>
<td>76,2</td>
<td>81,6</td>
</tr>
<tr>
<td>France</td>
<td>54,1</td>
<td>67</td>
<td>72,9</td>
<td>82,4</td>
</tr>
<tr>
<td>UK</td>
<td>38,3</td>
<td>62,1</td>
<td>75,1</td>
<td>91,8</td>
</tr>
<tr>
<td>Japan</td>
<td>80,4</td>
<td>104,6</td>
<td>115</td>
<td>143,5</td>
</tr>
</tbody>
</table>

* Forecast

Even bank insolvencies are continuing, especially in the US. The regulatory authorities had to close down 140 financial institutions in 2009, and in the first two months in 2010, a further 26 banks were shut down (FTD 2010b).

The impact of the crisis will be measurable even in the real economy for several years to come. An increase in unemployment, an additional burden for social security systems and weak growth is to be expected. The high public debt (see Fig. 2) that has been caused by the bailouts for banks and stimulus packages in many countries, however, is going to become a
long-term problem if there are no innovative solutions, such as a capital transfer tax (see Chapter 5.1, Box 3). Now that the financial industry has been earning unimaginable profits for many years, we are threatened with the socialisation of the losses, unless the financial sector is made to pay for the financial burden of the crisis.

1.4. More than a Financial Crisis

The financial and economic crisis struck at a moment when the world actually had other problems to worry about. The aggravation of the climate crisis and the foreseeable depletion of important resources require enormous political and economic efforts to avert greater catastrophes. Especially since Peak Oil, and oil is the energy basis of world economy, will soon be reached (Altvater 2005). On the agenda is the restructuring of the world economy to an economy without CO₂. The time factor has reached a new dimension. Previously, with the failure of social change, there was a consolation in the assumption that our grandchildren would be in a better situation to fight it out. But nowadays the physical and chemical processes in the biosphere remove this hope. These processes have their own logic that have nothing to do with political decision-making, complex diplomatic negotiations and underlying social conflicts. Climate change will reach a tipping point, a point of no return, within the next two decades, and from then on irreversible changes will be initiated, and no one will be able to do anything to prevent them. A unique challenge in the history of humankind lies ahead of us.

In this historic constellation, the financial and economic crisis is absorbing a large part of the political capacity to solve these problems as well as consuming valuable resources. It is deepening the world's social and economic asymmetries and tensions, bears the risk of competitive instead of cooperative solutions and wastes a lot of time. Its effects are much more far-reaching than many analysts would like to acknowledge with their blurred view in the world of feigned seriousness dressed in pinstriped suits.

Last but not least, the crisis also represents the bankruptcy of the scientific foundations of financial capitalism: Neoclassical Economics and Monetarism. The financial industry players did not understand the system that has now collapsed, just as their satellites in media and academia. Their theories have turned out to be ideologies that did not pass their practical exams.
2. The Crash and the South

The financial crisis is the first really global economic crisis, in the true sense of the word. The developing countries and emerging economies had no possibility of escaping this crisis. However, the countries in the global South differ very much from each other, and so were variably affected in terms of extent and depth of impact. This impact depended on different parameters, for instance the country's integration into the world economy, the structure of the national economy, as well as their political and economic stability before the crisis. Therefore, some of the countries are starting to recover, while others are only just experiencing the effects of the crisis. An exact analysis of the individual countries offers a very multi-faceted picture.

A commonality between such different worlds as China and Burkina Faso, between Brazil and Nepal is irrefutable: because of globalisation, the emerging economies and the developing countries have been integrated into the global economy for some time to an extent that made it inevitable that they would also be hit by the crash – even though they were not involved in its creation. This shows that it is imperative that a functioning and stable financial system which is shaped according to the needs of all human beings is considered a Global Public Good.

2.1. Paths of Contagion

The transmitting of the crisis to the emerging economies and the developing countries mainly occurred through two channels - directly through financial relations or indirectly via the real economy. In most cases, the financial relations played more of a subordinate role: because of a smaller extent of integration into the global financial markets and due to the "backlog" in providing speculative business models, the repercussions of the crisis through the financial markets remained moderate. The most important effect was the decline in credit.

The repercussions of the crisis in the real economy of the industrialized countries on the global South were much more severe – i.e. the decline in FDI, global trade and, in many poorer countries, the decline of remittances from migrants as well as a collapse in development aid over a broad front.

2.1.1. Decline in Financial Flows

In the years before the financial crisis, the private financial flows – i.e. loans/debts, portfolio investment, FDI, migrants' remittances – especially to the emerging economies, but also to developing countries, experienced a strong increase, by a total of 5% of the GDP of the emerging economies and developing countries from 2000 to 2007 (World Bank 2010a: 6). Regionally, the rise amounted to 2% of the GDP in the Far East, Latin America and the Caribbean, in the Middle East and Northern Africa, in South Asia 7% and in Sub-Saharan Africa 4% (ibid.). All in all, a remarkable increase.

This increase occurred for several reasons. On the one hand, the (commodities) boom in the emerging economies increased export earnings. Additionally, investments and participations were attracted in the booming industries and borrowing increased. Finally, institutional investors were also seeking speculative opportunities promising high profits all around the globe, for instance, in Carry Trade (see Chapter 2.1., Box 1). Consequently, the countries targeted for speculation money were affected by the dynamics of the crisis.

Following the crash, and for the first time since 1997, the upward trend in financial flow was reversed in 2008, a change that was then aggravated in 2009. For instance, private loans to
emerging economies and developing countries decreased from 236 billion USD in 2008 to 123 billion USD in 2009. That is a decrease by nearly half. (World Bank 2010a: 20). Foreign direct investment decreased from 621 billion USD in 2008 to 406 billion USD in 2009 (UNCTAD 2010c:2).

The largest component of outflow consists of portfolio investment, i.e. relatively short-term assets, highly liquid financial assets (shares, bonds, foreign exchange, all sorts of derivatives and other liquid assets). Portfolio investments are, of course, capital flows that can be most easily and quickly withdrawn. If investors/speculators consider turbulences on the markets to be too strong, they look for secure havens. The most secure haven is still the US and the Dollar.

Long-term assets, foreign direct investment and longer term loans are not so mobile and cannot be withdrawn at short notice in times of crisis.

The decline in portfolio investments occurred for a number of reasons:

- The institutional investors who lost large sums during the crisis, had to sell shares to compensate for these losses. Such sales, as well as the speculators' reduced readiness to take risks, led to a general drop in shares on the stock exchanges, regardless of whether these shares were themselves threatened by the bursting speculation bubble.
- Many players on the financial markets considered this general decline as a sign that the rise in share prices in previous years – called a "bull market" in stock exchange parlance – could reverse into a long-term downward trend, a so-called "bear market".
- As always, the fear of such a fall in prices across all sectors of the stock exchange lead to typical herd reactions: just as in previous years, when the shares prices always increased because institutional investors were convinced that the bull market would persist, and continued to invest and thus drove share prices upwards. The share prices were now decreasing because during the crisis, many investors quickly believed that a bear market was coming. For this reason, shares were sold to avoid stock market losses. But this actually accentuated stock market losses. A typical case of a self-fulfilling prophecy, and of the irrationality on the financial markets.

This herd behaviour had the effect that stock exchanges all over the world suffered a synchronized slump irrespective of the economic situation in the individual countries.

This capital flight seems to have stopped since Spring 2009: portfolio investment has again increased and the stock exchanges have correspondingly recovered again. However, this recovery turned out to be different from country to country, and the shares markets only reached pre-crisis levels in some countries, for instance in Brazil. The majority of shares markets in emerging economies and developing countries – such as China, Kenya, South Africa and Nigeria – have recovered but are miles away from the levels of 2007: „Financial markets have stabilized and are recovering, but remain weak.“ (World Bank 2010a:15).

The direct effect of the slump in shares is that, on the one hand, access to capital for incorporated companies has clearly deteriorated in the respective countries – because they receive less money for newly issued shares and because their stock-market price and thus their credit rating for potential lenders has declined. A second direct effect is that domestic banks which have invested in shares have lost huge sums in many countries.

The effects of the slump on portfolio investment do not of course mean that portfolio investment as such could be seen as a sensible development instrument in the sense of sustainability and social justice. On the contrary, the financial crisis in Asia in 1997 showed portfolio investment that is oriented towards short-term high profits can be extremely detrimental to developing countries and emerging economies. However, if these capital flows
cease to exist without a substitute in the form of more useful financial or developing instruments, this, for the time being, leads to a weakening of the countries concerned.

**BOX 1: Carry Trade**

A direct way for transmitting the financial crisis to emerging economies is the so-called *Carry Trade*, a form of speculation on differences in interest rates between two currency regions. Carry Trade was already a recurring phenomenon in the financial crises of the 1990s in the emerging economies (UNCTAD 2009a: 43).

How does Carry Trade work? For instance, there is the example of Japan and Brazil: an institutional investor takes out a loan in *Yen* in Japan, which has very low interest rates of about 1%. This sum is then exchanged for *Reais* in Brazil and then offered as a loan since the interest rates in Brazil are 12%. After some time, this can be days, weeks or months – this loan is paid back in Japan. The cycle can then be repeated. The difference in interest rates, in this case, 10%, is the gross profit for this business model. If a – leveraged – input of hundreds of millions is invested, this leads to a substantial profit.

The other side of the coin is on the one hand, that the interest rates for the loan in Reais have to be financed by the Brazilian economy even without the crisis, only to be then withdrawn from the country.

On the other hand, *Carry Trade* is an instability factor. In the course of the crisis, institutional investors in Brazil abruptly abandoned their positions. In October 2008, a devaluation of the Brazilian currency by 25% occurred and led to a drop of share prices. Vice versa, the return of money to Japan led to a revaluation of the Yen.

**2.1.2. What Financial Markets and Hunger have to do with each other**

A drastic example that is especially notable from a development perspective, is the speculation in food prices, which threatens the lives of millions of people in the developing countries and is hidden behind a facade of pinstriped suits and feigned respectability. The food prices had risen dramatically worldwide at the end of 2007 (see Fig. 3). The FAO Food Price Index showed an increase in prices of 71% in the 15 months between the end of 2006 and March 2008. The rise was especially dramatic in the cases of rice and cereals, where the prices sky-rocketed by 126%. These price increases were mainly caused by financial speculation.

This was fiercely denied at the time when the prices were increasing. Since price setting is indeed a complex matter, all sorts of factors were put forward to explain the rise in prices, for instance, increasing demand in emerging economies – the Chinese are consuming more milk – or the production of agrifuels.

When the prices decreased again from July 2008 onwards, these supposed causes disappeared into thin air. Because these supposed factors are long-term factors, they would not rise so steeply in the relatively short time of ten months nor would they drop again in an even much shorter time. The Chinese do not start eating Yoghurt at such a rapid rate only to stop again within a few months, and the cultivation of agrifuels does not absorb agricultural land that fast.

However, the price curve does have the typical shape of a speculative bubble. The reason for the increase: the *Subprime Crisis* was transformed from a mortgage crisis to a loans crisis. Whole segments of the market collapsed, such as that of toxic derivatives. Investment banks and Hedge Funds suffered losses of two-digit billions. To the extent to which speculation in the financial sector became more difficult, the investors desperately looked for new markets and then jumped onto the commodities markets, mainly oil, but also agricultural commodities.
The trade in agricultural futures and other derivatives increased by 32% in 2007. At the same time, the value of commodities derivatives that are traded over the Counter, i.e. off-market, rose by nearly 160% between June 2005 and June 2007. The number of futures between October 2007 and the end of March 2008 increased by 65% on the Chicago Mercantile Exchange, without a corresponding increase in real production (Bank for International Settlements 2008a).

This meant that the bubble had started to inflate. The price increase in derivatives then led to an increase in spot market prices. On the one hand, buyers on the spot markets bought more reserves to hedge against further price increases. This increased demand and created pressure for price increases. On the other hand, sellers waited with their sale, expecting higher prices and consequently restricted supply. The speculation of institutional investors set off a chain reaction of speculative behaviour among other players.

Additionally, speculation not only played a direct role through food stock exchanges, but also indirectly through the oil price. Oil is involved in all phases of agricultural production and distribution. As in the case of food prices, the oil price bubble in this period was mostly due to speculation. Thus, speculation was involved in a two-fold way in creating the food prices bubble.

The commodity prices dropped drastically from July onwards. This was also caused by the financial crisis which was aggravated in this period. Hedge Funds and other institutional investors found that commodities speculation was also too risky because of the crisis in real economy. A new wave of capital fight was initiated, this time into US Treasury Bonds, practically the last haven capital could escape to.

From the German side, the Deutsche Bank was also involved into food speculation. In May 2008, the bank advertised their Agriculture Euro Fund on paper bags for bread: „Do you enjoy increasing prices? The whole world is speaking about commodities - the Agriculture Euro Fund offers the possibility for you to participate in the performance of seven of the most important agricultural commodities“ (WAZ 2008).
The result of this business model: „Between 109 million and 126 million people may have fallen below the $1 per day poverty line since 2006 owing to the increase in food prices. (...) All else being equal, the incidence of extreme poverty in sub-Saharan Africa may have risen by almost 8 percentage points, implying that the recent food price increases have more than offset the poverty reduction achieved between 1990 and 2004.“ (UNO 2009: 26).

Meanwhile, the role of speculation in futures in setting commodity prices has also been acknowledged by some governments. For example, the French government published a study that analysed the role of speculation in the example of oil. The main findings of the study are:

• financial markets have a substantial influence on price volatility,
• the bubble of 2008 can occur again at any time,
• the behaviour of financial markets constitutes uncontrollable risks,
• the question of oil price volatility is ultimately a question of the regulation of financial markets,
• The behaviour of players on the financial markets also applies to other commodities, i.e. to food as well. (Ministère de l’Economie, de l’Industrie et de L’Emploi 2010).
2.1.3. Decline in Foreign Direct Investment

Foreign Direct Investment (FDI) refers to an investment made either directly to acquire property in a country or a share in a company that is big enough to give the investor an effective voice in the company's management (UNCTAD 2010a). A classic example of foreign direct investment is a German car company that builds or purchases a company in China to have car parts or whole cars produced in these factories.

The largest part of global FDI flows between industrialized countries. However, FDI has massively increased in emerging economies and developing countries in recent decades, rising from 10% of their common GDP in 1980 to 30% in 2008 (DIE 2008). This makes FDI the main source of income for emerging economies and developing countries, and they form the main pillars of development strategy in many countries. FDI is bound up with hopes of positive effects on employment, income and tax revenue in the recipient countries and with so-called spillover-effects for the economy of the recipient country which is supposed to profit from the transfer of investment, technology and knowledge.

The strong increase in FDI since 1980 is an important indicator of economic globalisation, i.e. of the extent of integration of emerging economies and developing countries into the global economy: Global FDI capital flows peaked in 2007, 1,400 billion Euros (British billions) were invested, that is, more than 25% of the amount in 2006 and three times the amount of ten years previously (UNCTAD 2010b). Unlike portfolio investment, FDI is less often made by institutional investors. Instead, it is carried out primarily by real economy companies. Nevertheless, the crisis has massively affected FDI capital flows. This is because the financial crisis diminished the prospects for loans and the future prospects of these companies - and this had the effect of many companies reducing their foreign direct investment. Consequently, FDI already fell by more than 14% in 2008 when compared to the previous year (see Fig. 4). A decline of more than 35% compared to 2007 is to be expected for 2009 (UNCTAD 2009b: 37). According to UNCTAD estimates, the sum total of foreign direct investment is expected to increase again from 2010 onwards, but nevertheless, is expected to remain clearly below the pre-crisis level which will not be reached again in 2011 either.

Fig. 4: Decline of Foreign Direct Investment

Development of foreign direct investment worldwide (in billion US-Dollar)

* estimate, ** forecast, 

Source: UNCTAD 2009b, UNCTAD 2010b
This drop in FDI has not been distributed equally across the globe. In 2008, the slumps mainly affected the industrialized countries. The decline in FDI also reached the emerging economies and developing countries in 2009. The larger emerging economies of Brazil, Russia, China, India, which were already called the global economy's catalysts of growth before the crisis because of their strong economic performance, were not hit as hard by the decreases and managed to recover faster than many other countries because their markets are considered less attractive.

2.1.4. Decline in Remittances from Migrants
Remittances are transfers from labour migrants to their home countries which they transact to support their partner, families and/or friends. These often constitute a substantial contribution to the subsistence of the recipients, and such transactions frequently lift the recipients out of poverty. Consequently, remittances play an important role, a role that is increasingly significant for development.

Remittances have massively increased in recent years: from $83 billion in 2000 to $338 billion in the year 2008 (World Bank 2009c: 1). This means that the total sum of remittances is nearly three times the sum total of official global development assistance. Correspondingly, such remittances represent a substantial part of the Gross Domestic Product in many developing countries - about 20% in Lebanon, in Honduras and in Haiti, and more than 10 per cent in a large number of other countries (UNCTAD 2009c: 23).

These capital flows play an especially important role in times of crises, since remittances normally develop anti-cyclically: migrants usually transfer more money from abroad when their countries of origin experience times of crisis. They do this to protect their social networks from the effects of the crisis, such as unemployment.

The global financial crisis has led to a disruption in this anti-cyclical development. Because the extent of the crisis is global and its epicentre lies precisely in those countries where many migrants work, the crisis not only affects the recipients of the remittances in the emerging economies and developing countries, but also the migrants, especially in North America and Europe. Many of these are among the first to lose their jobs because of the crisis. Consequently, the remittances decreased in 2009, in contrast to the trend seen over decades. The fall has been estimated at - 6 per cent, that is, down by 317 billion US-Dollars (World Bank 2009c: 14). A recovery is expected in 2010, but this is at such a low level, that the previous level of 2008 will not even be reached again by 2011. Thus, the development in remittances could not counteract the crisis anti-cyclically but reinforces it pro-cyclically. Even though the effects of this development have not been studied empirically so far, it is to be assumed that the decline in remittances, together with other means of transfer has increased the risk of many families in emerging economies and developing countries of becoming impoverished by the crisis.

2.1.5. Decline in Development Assistance by Several Donor Countries
The financial crisis has also led to a decline in Official Development Assistance – ODA) in many donor countries (see Table 1). ODA was clearly increasing before the crisis, even if the rates of increase were below the promised levels.

At the end of the 1990s, the amount of assistance provided had reached a historical all-time low – the main donor countries were only spending 0.22 per cent of their Gross National Income (GNI) on ODA in 1997. After that, the assistance increased again.

The so-called Monterrey Consensus on development financing was adopted in Mexico in 2002. The big donor countries committed themselves to the objective of increasing ODA to
the level of 0.7 per cent of GNI that had been promised for decades. Even six years later, most donor countries remained far beyond this level\(^2\). Until 2008, ODA had at least increased to an average rate of 0.3 per cent of GNI, reaching the highest absolute level of its history – 121,5 billion US-Dollar (UNO 2010: 85).

**Fig. 1 Development of ODA 2008 - 2009**

<table>
<thead>
<tr>
<th></th>
<th>2009 Million USD</th>
<th>% of GNI</th>
<th>2008 Million USD</th>
<th>% of GNI</th>
<th>Change '08 - '09 Million USD(^1)</th>
<th>% of GNI(^1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>2.761</td>
<td>0.29</td>
<td>2.954</td>
<td>0.32</td>
<td>2.912</td>
<td>-1.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.601</td>
<td>0.55</td>
<td>2.386</td>
<td>0.48</td>
<td>2.661</td>
<td>11.5</td>
</tr>
<tr>
<td>Denmark</td>
<td>2.810</td>
<td>0.88</td>
<td>2.803</td>
<td>0.82</td>
<td>2.922</td>
<td>4.2</td>
</tr>
<tr>
<td>Germany</td>
<td>11.982</td>
<td>0.35</td>
<td>13.981</td>
<td>0.38</td>
<td>12.297</td>
<td>-12.0</td>
</tr>
<tr>
<td>Finland</td>
<td>1.286</td>
<td>0.54</td>
<td>1.166</td>
<td>0.44</td>
<td>1.319</td>
<td>13.1</td>
</tr>
<tr>
<td>France</td>
<td>12.431</td>
<td>0.46</td>
<td>10.908</td>
<td>0.39</td>
<td>12.746</td>
<td>16.9</td>
</tr>
<tr>
<td>Greece</td>
<td>607</td>
<td>0.19</td>
<td>703</td>
<td>0.21</td>
<td>618</td>
<td>-12.0</td>
</tr>
<tr>
<td>Great Britain</td>
<td>11.505</td>
<td>0.52</td>
<td>11.500</td>
<td>0.43</td>
<td>13.179</td>
<td>14.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.000</td>
<td>0.54</td>
<td>1.328</td>
<td>0.59</td>
<td>1.077</td>
<td>-18.9</td>
</tr>
<tr>
<td>Italy</td>
<td>3.314</td>
<td>0.16</td>
<td>4.861</td>
<td>0.22</td>
<td>3.350</td>
<td>-31.1</td>
</tr>
<tr>
<td>Japan</td>
<td>9.480</td>
<td>0.18</td>
<td>9.579</td>
<td>0.19</td>
<td>8.556</td>
<td>-10.7</td>
</tr>
<tr>
<td>Canada</td>
<td>4.013</td>
<td>0.30</td>
<td>4.795</td>
<td>0.33</td>
<td>4.341</td>
<td>-9.5</td>
</tr>
<tr>
<td>Korea</td>
<td>816</td>
<td>0.10</td>
<td>802</td>
<td>0.09</td>
<td>910</td>
<td>13.5</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>403</td>
<td>1.01</td>
<td>415</td>
<td>0.97</td>
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<td>New Zealand</td>
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<td>348</td>
<td>0.3</td>
<td>337</td>
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<td>Netherlands</td>
<td>6.425</td>
<td>0.82</td>
<td>6.993</td>
<td>0.8</td>
<td>6.675</td>
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</tr>
<tr>
<td>Norway</td>
<td>4.086</td>
<td>1.06</td>
<td>3.963</td>
<td>0.88</td>
<td>4.650</td>
<td>17.3</td>
</tr>
<tr>
<td>Austria</td>
<td>1.146</td>
<td>0.30</td>
<td>1.714</td>
<td>0.43</td>
<td>1.179</td>
<td>-31.2</td>
</tr>
<tr>
<td>Portugal</td>
<td>507</td>
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<td>620</td>
<td>0.27</td>
<td>523</td>
<td>-15.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.546</td>
<td>1.12</td>
<td>4.732</td>
<td>0.98</td>
<td>5.083</td>
<td>7.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2.305</td>
<td>0.47</td>
<td>2.038</td>
<td>0.44</td>
<td>2.271</td>
<td>11.5</td>
</tr>
<tr>
<td>Spain</td>
<td>6.571</td>
<td>0.46</td>
<td>6.867</td>
<td>0.45</td>
<td>6.786</td>
<td>-1.2</td>
</tr>
<tr>
<td>USA</td>
<td>28.665</td>
<td>0.20</td>
<td>26.842</td>
<td>0.19</td>
<td>28.305</td>
<td>5.4</td>
</tr>
<tr>
<td><strong>Sum total</strong></td>
<td><strong>90.908</strong></td>
<td><strong>0.31</strong></td>
<td><strong>122.296</strong></td>
<td><strong>0.30</strong></td>
<td><strong>123.119</strong></td>
<td><strong>0.7</strong></td>
</tr>
<tr>
<td><strong>EU donor countries</strong></td>
<td><strong>67.135</strong></td>
<td><strong>0.44</strong></td>
<td><strong>70.974</strong></td>
<td><strong>0.43</strong></td>
<td><strong>70.838</strong></td>
<td><strong>-0.2</strong></td>
</tr>
</tbody>
</table>

\(^1\) adjusted for inflation and currency

Source: OECD DAC 14.04.2010

\(^2\) Thus, the commitments made in Gleneagles by the G8 countries and at several UN summits were not honoured. Instead of the promised 25 billion US dollars, Africa has only received 12 billion US dollars, that is, not even half (OECD 2010c).

\(^3\) [www.oecd.org/dataoecd/17/9/44981892.pdf](www.oecd.org/dataoecd/17/9/44981892.pdf)
The financial crisis now threatens a further increase in ODA. In April 2009, the G20 did actually assure that there would be no cut in ODA because of the crisis. Nevertheless, the budgets of the big donor countries have come under big pressure because of the effects of the crisis, and this will be reinforced in many countries over the following years because of strongly increasing public debt.

Consequently, ODA is being reduced in many countries. This could already be seen in 2009, for instance in Germany (-12%), Austria (-31%), Canada (-9%), Japan (-10.7%), Italy (-31.1) and Ireland (-18.9). The EU donor countries overall reveal a decrease by 0.2%. There still was an overall increase of 0.7% or 823 million USD. This was only because some countries increased their ODA, some by a substantial amount, for instance France (+16.9%), Great Britain (+14.6%) and Norway (+17.3%). If we compare this to the amounts that we had to get used to during the massive bailouts for banks, these are practically peanuts.

Assistance will also reach a peak in absolute figures in 2010 according to forecasts of the OECD Development Assistance Committee (DAC), but the commitments that were made at the G7 Summit in Gleneagles and the Millennium Summit +5 (2005 World Summit), will not be met. This applies especially to Sub-Saharan Africa. There, instead of the promised doubling of assistance to 50 billion USD by 2010, only 37 million will be received.

Past experience provides no grounds for optimism in relation to the promises of donor countries being kept in times of crisis: ODA was reduced by an average of 13 per cent during previous crises within some countries as Emmanuel Frot of the Stockholm Institute for Transitions Economics showed in a study (Frot 2009).

Such breaching of commitments is disastrous for poor countries in the current crisis. While the pressure to reduce ODA will increase in donor countries over the coming years, the need for assistance by recipient countries has strongly increased. The donor countries would have to react to the crisis anti-cyclically and increase ODA instead of reducing ODA in order to counteract this widening divide.

2.1.6. Decreasing Demand, Decreasing Prices - the Decline in Global Trade

The development of global trade reflected the development of the world economy since 1945. It has increased steadily and strongly. Global trade only suffered a reduction over the past three years – initiated by recessions in the industrialized countries – and by no more than 5% in each case. Consequently, the decline in global trade by nearly 13 per cent in 2009 (UNO 2010: 47) is unique in the post-war era – a similar decline only occurred during the Great Depression after 1929 (see Fig. 5).

Industrialized countries' trade had already started to decrease in Summer 2007. The sharpening of the financial crisis in September 2008 and the corresponding deterioration in economic conditions then led to a decline of world trade in all regions in Autumn 2008: imports declined and subsequently, industrial goods production and exports were reduced on a global scale because of the strong fall in demand for manufactured products. At the same time, the possibilities for financing trade through trade credits, etc. deteriorated: trade credits ran short and the interest rates for trade credits grew up to 300% (UNO 2010: 48).
The worldwide decline in industrial production and demand led to a fall in commodity prices, with important consequences for developing countries. The prices for commodities – such as oil, minerals, metals and agricultural commodities such as cereals, oilseed, coffee and tea – steadily increased since 2004, and then, after reaching a historic peak in Spring 2008, a drastic collapse followed. Food prices on international markets dropped by a quarter, some goods, such as oilseed and vegetable oils, fell by more than 50% below their highest price, and this was after a preceding price bubble produced disastrous effects for food security in many poor countries (see Chapter 2.1.2 for more details). The oil price even dropped by more than 70 per cent.

The impact of the decline in global trade affected all emerging economies and developing countries. Although the collapse in commodity prices meant relief for importing countries, it had an additional impact on countries exporting commodities. The impact varied enormously for a given country, depending on the situation of that country as an importer or exporter of commodities. The decline in demand for industrial products had a huge impact on emerging economies dependant on exports in South East Asia, such as South Korea and Indonesia. On the other hand, the fall in prices for commodities that were caused by the global economic slowdown had some ambiguous effects: exporters of oil and minerals in Africa and Latin America such as Nigeria, Ecuador, Venezuela, and Trinidad and Tobago suffered from the collapse in prices (UNO 2010: 52/53). Those countries which are dependant on importing commodities, especially oil, experienced a certain relief. In most cases, this relief due to lower prices for energy commodities was offset by the simultaneous collapse in prices for their own export goods.

Global trade and commodity prices are on the rise again as of Summer 2009. Most commodity prices have again reached the level of 2006, the total volume, however, will not
attain its pre-crisis level until 2011 at the earliest. It has been estimated that severe losses amounting to 5 trillion US-dollars must be expected from 2008 to 2010 (UNO 2010: 47). The consequences resulting from these are massive and very similar, regardless of the export industry's sector or location: reduced investment, company bankruptcy, lower wages and unemployment.

The crisis was also transmitted through these channels from the export industries to those sectors which are actually independent of exports: less investment, for instance, has a negative impact on the construction industry, as they receive less building contracts from the export industry. Lower wages and job cuts signify a decline in domestic demand, and this causes all sectors to suffer - the car trader who sees the number of customers from the middle and upper classes reduced due to the crisis, as well as the hairdresser who has less to do because laid-off workers have less money in their pockets.

Meanwhile, the trade crash has been stopped: "Trade too is recovering but remains depressed." (World Bank 2010a: 15).

2.2. Balance of Payment Deficits and Excess Debt - The Macro-economic Effects of the Crisis on Emerging Markets and Developing Countries

The combined impact of the effects of the crisis described above can be summarized under one common denominator: the economic conditions for emerging economies and developing countries have been drastically aggravated by the crisis. Although countries were affected in different ways by this development, there was a common pattern that is paradigmatic for the unfolding of economic processes in globally effective crises: because of the decline in global demand, the exports of nearly all countries fell - and as a result, so did the earnings of the export industries. Subsequently, wages in these economic sectors were lowered, workers were laid off, production was reduced and new investment was restricted.

At the same time, financial markets reacted in most countries. Declining portfolio investments and FDIs reduced the cash flow into the economy even if these countries were not directly affected by the crisis. This shortage of money was made worse by the scarcity of loans in all those countries where the financial industry reacted to the crisis pro-cyclically through restricting the allocation of credit.

The crisis in the export industries and the developing "credit crunch" were together responsible for the fact that those economic sectors that did not depend on exports were also affected by the downward spiral of the crisis: domestic demand declined in most developing countries and emerging economies because of a drop in investment and loans on the one hand and increasing unemployment on the other hand.

However: while many industrialized countries entered into a recession, i.e. their economy started to shrink (negative growth), there was no recession in the emerging economies and developing countries (see Fig. 6).

Nevertheless, there were many cases of balance of payments deficits, and where they already existed before the crisis, these deficits grew larger.

The crisis did not remain restricted to the economy, but also spread quickly to public finances. On the one hand, there was less tax income because of the crisis, and on the other hand, bank bailouts and stimulus packages led to a strong increase in public spending, which in turn led in many cases to a dramatic rise in public debt.

Public financing in developing countries depends to a large extent on the taxation of a few export products – such as crude oil exports in the case of Nigeria (see Chapter 3.3) – and
consequently the decline in global demand had an especially devastating effect on the country’s budget. On the other hand, increasing poverty and unemployment lead to a greater burden on social security systems, even if these only exist in an underdeveloped form. And last but not least, there is the burden caused by the stimulus packages that were also put into operation by many newly industrialized economies and developing countries as an anti-cyclical measure to counteract the crisis. Many countries of the South are threatened by excessive debt because of this combination of loss of state income and the simultaneous need for increased public spending.

**Fig. 6: Growth Trends in the Crisis**
Annual economic growth of emerging economies and developing countries and industrialized countries by comparison (percentage)

Debt started to rise again in 2009 after excessive debt had been eliminated or at least visibly reduced in many of the previously highly-indebted developing countries and newly industrialized countries over the previous ten years (see Fig. 7).
Fig. 7: Debt in the South is increasing again
Development of public debt in selected emerging economies and developing countries (in percentage of GDP)

*estimates, ** forecast  
Source: EIU

2.3. The Social Effects of the Crisis: Increasing Poverty, Unemployment and Precarisation

Even two years after its outbreak, the effects of the crisis on the social situation of the population in different regions and countries can still not be estimated. Past experience has shown that it may take several years before the social effects of economic crises are clearly visible. We can already see at this point that the positive social developments that were achieved within the previous ten years have been interrupted and even reversed because of the crisis.

According to the World Bank, 30,000 to 50,000 children have died in Sub-Saharan Africa alone as a direct effect of the crash (World Bank 2010a: 4). This amounts to as many as the entire population of an average small town in Europe and ten times the number of victims of the terrorist attack on September 11, 2001.

Of course, the life of one human being cannot be measured against the life of another. However, the discrepancy between the historical reaction to the effects of September 11th and the absence of response to the silent deaths of these children can only leave us speechless.

The increase in absolute poverty caused by the crisis, i.e. the number of people that are forced to survive on less than 1.25 USD per day (0.91 Euros according to the exchange rate of March 15, 2010), is equally dramatic, the increase amounts to 114 million (World Bank 2010a: 41).

And when we speak about absolute poverty, this is only part of the poverty. Those who have 2 USD per day are still very poor.

Another calamitous effect of the crisis on the social situation of the population is increasing unemployment. Unemployment significantly increased again in the year 2009 following a decline over the four years preceding the crisis: In 2009, over 30 million more people were unemployed than in 2007 (see Fig. 8).

The greatest increases in unemployment occurred in the economies at the epicentre of the crisis – the industrialized countries. The emerging economies in Eastern Europe and the global South are also affected by increasing unemployment. There are indeed massive
regional and national differences (see Chapter 3). However, no part of the world was able to escape the general trend of increasing unemployment (ILO 2010: 46).

Fig. 8: increasing unemployment.
Number of unemployed (in millions)

*estimate, **forecast

Women and young people were especially affected by the increase in unemployment. Precisely in those regions where, in comparison to men, women suffer strong discrimination in the labour market – for instance in South Asia, Latin America and the Caribbean, the Middle East and North Africa, but also in the European Union – the increase in unemployment was greater for women than for men. The situation of young people in the labour market is similar: young people are more likely to be affected by unemployment than adults even outside times of crises, and during the crisis they suffer more than adults: adolescent unemployment increased at twice the rate of adult unemployment.

The prospects for recovery in the labour market are grim. Experience with previous crises shows that it takes several years, when the economy starts to grow again following an economic crisis, before the economic recovery is also reflected in visibly decreasing unemployment. However, the crisis has also aggravated the situation of those who still have jobs (or are working again). The proportion of those who have precarious jobs - badly paid and without much social security – has increased because of the crisis: the percentage of precarious employment decreased steadily between 1998 and 2008, only to increase again by more than 1 per cent in 2009. The proportion of low-waged jobs with low productivity and bad working conditions, that is jobs which contradict fundamental labour rights, has increased.

This means that more than 100 million people worldwide have fallen below the poverty line as defined by the World Bank because of the crisis. According to estimates of the International Labour Organisation (ILO), a similarly large number, has become extremely poor in the course of the crisis. According to the World Bank definition, the category of extremely poor encompasses all those, that survive on less than 1.25 US-Dollar a day. This means that there has been a kind of "elevator effect": a large part of those who were above the poverty line beforehand, fell below this line in the course of the crisis – through losing their
jobs, lowered wages or precarisation; and at the same time, many who were already poor previously were driven into extreme poverty by the crisis.

But these numbers do not say much about the fate of individual people – for instance, about the millions of workers in the Chinese Pearl River Delta, whose minimum wage was cut by the Chinese government as a reaction to the crisis; or about those female workers in Bangladesh's textile industry, who lost their jobs when international demand for textiles collapsed because of the crisis. Neither do the statistics tell us about the indirect effects of aggravated economic poverty: the lost education prospects of millions of children whose parents are forced to take them out of school so that they can contribute to family income; about those countless female and male workers that cannot afford basic health care because of unemployment or decreasing wages, and finally all those families and children dependant on waged labour, who cannot support themselves with food due to the crisis and are threatened by hunger.

**Fig. 9: Poverty is on the rise again**
Number of people whose income is below 2 US-Dollars per day (in millions)

![Graph showing number of people in poverty from 1999 to 2009](image)

*figures for 2008 and 2009 are estimates

Source: ILO 2010

If the ILO forecasts are accurate, that is, that the recovery of the global labour market will take several years before the pre-crisis level is reached – then millions of people around the globe face a lost decade of development.
3. Case Studies
As mentioned above, the impact of the crisis has been very different in the various emerging markets and developing countries. The nature of these differences can be shown by the following case studies in Kenya, Brazil, Nigeria, South Africa, India and China. The variations between the countries should not deter us from acknowledging common conclusions provided by the case studies: they show how a weaker integration into the global financial markets and relatively strict regulation pays off. They increase stability with respect to the external shock effects of the crisis.

Additionally, the case studies show that in those countries, where the governments have the political will and are economically able, the governments can counteract the impact of the crisis with anti-cyclical, classical Keynesian policies - by reducing interest rates, boosting liquidity, by state intervention into the banking system, and even by carrying out nationalisations and providing extensive stimulus packages.

But the case studies also show that the developing countries and newly industrialized countries have already been integrated into the global economy to such a high degree that even the most effective economic and financial policies cannot protect them from the impact of such a crash.

3.1. Kenya
Unlike many industrialized countries, the financial crisis is only one of many serious problems facing Kenya with regard to economic development. The East African country had to cope with three crises at once over the last three years: the political crisis that followed the elections to the national parliament in December 2007 which led to bloody uprisings and a massive collapse in Kenya's economy; the global food crisis which had a serious impact, especially on the poorer sector of the population because of price increases in basic foodstuffs such as rice, maize, vegetable oil, etc., and, finally, the drought, which seriously affected agriculture in 2008 and 2009 (Social Watch Report 2009: 108). The combined effect of these three crises was to cause Kenya's economic growth to drop to a mere 1.8 per cent in 2008 - following 7.1 per cent in the previous year (IMF 2010a). The financial crash hit Kenya's economy when it was in many ways already in an unstable condition, a typical situation for many poor countries.

Kenya's financial industry itself was not affected by the crisis: Kenya's banks were not involved in speculation on the US real estate market and therefore remained stable even after the bubble had burst (World Bank 2009d: 4). This did not prevent the transfer of the crisis to Kenya through other indirect channels: portfolio investment was strongly reduced in Kenya because of the crisis – and subsequently, the stock exchange, when it reached its lowest level in Spring 2009, was more than 50 per cent below the level of 2007. The index had still not reached its pre-crisis level by the beginning of 2010 (Nairobi Stock Exchange 2009: 2, Nairobi Stock Exchange 2010: 3). Equally, FDIs have severely decreased since the outbreak of the financial crisis (World Bank 2009d: 4). Remittances to Kenya also fell slightly in comparison to the previous year - after they had strongly increased each year in the past (Central Bank of Kenya 2010). This decline was preceded by a large increase in 2008, when Kenyans in exile substantially increased their remittances during the political uprisings.

Besides cash flows, global demand also decreased with mixed effects for Kenya. On the one hand, lower prices for oil, food and fertiliser provided a certain relief for Kenya's economy, since Kenya is not rich in natural resources and has to import commodities, especially oil, and was forced to import foodstuffs as a result of the drought. The other side of the coin is the decline in demand for some of Kenya's most important export goods, especially gardening products such as cut flowers, fruits and vegetables (World Bank 2009d: 6).
Taken in combination with the riots in 2008 and the drought in the same and in the following year, the financial crisis contributed to Kenya's agriculture shrinking in 2009, for the second time in a row. Agriculture contributes more than a quarter to Kenya's economy. The same applies to the tourist industry, another important branch of the economy in Kenya. Tourism increased strongly in 2009 compared with 2008, but only reached 93% of the volume of 2007, despite aggressive marketing and cut rate travel offers (World Bank 2009d: 3).

Kenya's government reacted to the financial crisis by a less strict monetary policy and with a stimulus plan. Kenya's Central Bank lowered the prime rate several times from Autumn 2008, in order to provide more and cheaper money for Kenya's markets. The government also adopted a stimulus plan that consisted of additional expenditure amounting to 22 billion Kenyan Shillings (about 200 million Euros) which was mainly intended to improve infrastructure and social security systems (World Bank 2009d: iii).

Kenya's economy is only recovering slowly in spite of these anti-cyclical policies. Although economic growth increased in 2009 when compared with the low level of 2008, but at 2.5 per cent, it still remains more than 4 per cent below the level of 2007 (IMF 2010). The effects of the slow recovery of the economy on Kenyan society are hard to assess because of the lack of empirical data. An acute aggravation of the social situation is to be expected – this is because economic growth was below poverty growth in 2008 and in 2009. This factor alone caused a decrease in per capita income. Additionally, state debt will increase as a result of the stimulus plan. The government wants to react to this development through an extensive privatisation programme, by which some of the last few companies still in public ownership are to be sold.

Kenya's prospects for a recovery from the other three crises is put at risk by the financial crisis and there is a danger that opportunities for development will be lost in the short and medium term. Additionally, the foreseen increased debt and privatisation means that Kenya will survive the crisis in a weakened state, even if the country manages to recover soon.

3.2. Brazil

Brazil has acquired the title of an economic child prodigy in the crisis: it was one of the last countries to suffer the effects of the crisis and is one of the first to come back to economic growth. Even if this analysis – published for instance in economic magazines such as the British Economist (Economist 2009) – is exaggerated, Brazil's resilience towards the crisis remains remarkable.

Economic growth still came up to 5.1 per cent in 2008, despite the crash in Autumn 2008. Economic growth in Brazil also experienced a heavy downturn in 2009, but at 1.8 per cent growth, it still managed to avoid the recession suffered by most industrialized countries. And from 2010 onwards, the IMF already forecasts growth rates of 4.7 per cent again (IMF 2010b: 6).

The inflow of foreign direct investment did not decrease substantially during this time, not even in 2009. FDI quickly returned again to its high level after a slight decline in Summer 2008, and for 2009, FDI flows amounting to 41 billion US-Dollar are expected – more than 15 billion above the average over the last ten years (Banco Do Brasil 2009: 44, UNCTAD 2010b). Although Brazil's economic development could resist the global downward trend, Brazil's stock exchange still collapsed, just as the big stock exchanges in the US, England and Japan did: the Rio de Janeiro stock exchange index lost nearly 50 per cent of its value between Spring and Autumn 2008. Foreign investors withdrew large amounts of money invested in Brazilian shares, so that portfolio investment in Brazil was even negative between Autumn 2008 and the Summer of the following year, i.e. investors withdrew more money than they invested. Nevertheless, the Brazilian shares market recovered quickly and it nearly reached pre-crisis levels again by Winter 2009 (New York Times 2010).
The pattern of short-term crisis and quick recovery was also repeated in Brazil's real economy: Brazil's car production decreased by more than 70 per cent between October and December 2008. It was not only the car industry which suffered, as the simultaneous increase in unemployment shows: several hundred thousand jobs were lost over the same period. Within a few months the official unemployment rate increased by more than one point to nearly 9 per cent. Brazil's economy managed to recover just as quickly as the crisis dramatically hit the real economy: car production nearly reached its pre-crisis level again in Summer 2009, and unemployment was cut back to 8 per cent, a figure that is similar to the level in the same period of 2008 (Banco Do Brasil 2009: 29ff).

The basis for Brazil's relative stability with respect to the crisis was the very favourable economic situation at the starting point: there had been a high degree of economic growth in the years preceding the crisis, the currency was stable, the country had a relatively low state debt and falling unemployment rates. Two more reasons were responsible for Brazil's resilience towards the crisis: on the one hand, Brazil's economy was comparably independent of world economy: Brazil's exports only amount to 14 per cent of GDP (World Bank 2010c). Consequently, Brazil was less vulnerable to a global decline in demand. Brazil's financial system is also relatively detached from the global financial markets: the Brazilian banks have been concentrating on the domestic market in the past and only participated to a small degree in speculation on the international financial markets. For this reason, Brazil's financial system remained stable in the crisis – no Brazilian bank had to declare insolvency or be bailed out by the state. On the other hand, foreign investors played a relatively minor role in the Brazilian economy: more than 80 per cent of Brazilian credit is completely independent of foreign investors (Banco Do Brasil 2009: 12).

The second reason for Brazil being able to quickly overcome the crisis was through the economic policy measures by which the Brazilian government and the Central Bank reacted to the crisis: on the one hand, the Central Bank eased equity capital restrictions for Brazilian banks in September 2008, so that they could provide an additional 118 billion Reals (46 billion Euros) in credit up to July 2009 than would have been permitted to according to the old rules. Additionally, the Central Bank reduced the prime rate to the lowest level for more than ten years. With these two measures, the Brazilian banks were able to partially compensate for the discontinuation of foreign credit. On the other hand, the government had already initiated a comprehensive stimulus package in 2007. This was intended to allocate 504 billion Reals (195 billion Euros) to investment in energy supply, social security and transport infrastructure over the period of 2007 to 2010 (PAC 2010). Both interventions into the market mitigated the effects of the crisis.

Despite the protective effect provided by the walling off of the Brazilian financial system and regardless of the success of the economic policy response to the crisis and the mild development of the crisis resulting from these factors, Brazil was nevertheless affected by the crisis. This crisis effect is shown by two pivotal development indicators – the proportion of poor people and the GINI coefficient which describes the social inequality of a society. Both indicators had fallen steadily before the crisis. This trend was reversed in 2009, following the crisis. For the first time in seven years, the proportion of poor did not decrease and the unequal distribution of wealth even began to increased again in 2009 (Banco Do Brasil 2009: 46ff).

Consequently, Brazil suffered a setback in its development because of the crisis, even though its financial system was barely touched by the crisis and although the country was economically very stable when it was hit by the crisis.
3.3. Nigeria

Nigeria's situation is one of permanent crisis according to the authors of the Social Watch Report 2009, and Nigerians have been living with this economic meltdown condition for a long time (Social Watch 2009: 128). The widespread corruption, a disastrous infrastructure which, for instance, only provides a third of the electricity needed and continuous armed conflicts for the control of oil fields in the Niger delta have been a heavy burden on the West African country over the past years. In this situation, the financial crisis and its effects have only added another heavy burden to those already suffered by Nigeria. The fastest route of contagion which transmitted the crisis to Nigeria was again portfolio investment: the Nigerian stock exchange practically imploded because of the crisis. Share prices decreased by over 60 per cent between March 2008 and the beginning of 2009 (FT 2009a).

Following this, the Nigerian banking sector also came under pressure: several banks which had provided extensive loans to investors which were used to speculate on the Nigerian stock exchange, were hit hard by the collapse in share prices. The collapse of the shares market meant that many investors could not repay their loans – and then the entire banking sector was brought to the brink of collapse. The Nigerian Central Bank intervened with a bailout package amounting to 600 billion Naira (2,7 billion Euro) to prevent a meltdown of the whole financial system and rescue 24 banks. At the same time, the Central Bank put eight banks under supervision (FT 2009a and FT 2009c).

A direct consequence of this transfer of the global crisis to the Nigerian financial system was the credit supply shortage. Foreign cash flows also decreased simultaneously with the shortage in domestic money supply for companies and private customers: FDIs were substantially decreased – by more than 20 per cent in the first six months of 2009 (Central Bank of Nigeria 2009: 66).

The Nigerian state mainly reacted to the crisis by easing monetary policy. The Nigerian Central Bank managed to provide an additional 200 billion Naira (900 million Euros) for the domestic economy in 2009 by cutting the prime interest rate and other monetary measures. This still could not prevent the sharp downturn in economic growth: Nigerian growth fell to 2,9 per cent in 2008, a reduction by half down compared to the previous year (IMF 2010a).

The reason for this decline was the collapse in growth in the agricultural and production sectors. Agriculture, especially, plays a very important role in Nigeria's economic growth, since oil production, which still dominates the Nigerian economy, has decreased because of social uprisings, corruption and mismanagement. Despite this decline, Nigeria, which is the most important oil producer on the African continent, still massively depends on its oil exports: it provides more than 95 per cent of export income and more than 80 per cent of the state budget income comes from the export of oil. Correspondingly, the collapse in the oil price as a result of the crisis, which at times fell to a third of its pre-crisis level, had a drastic effect (World Bank 2010d and ODI 2009:11).

Nigeria's export earnings dropped from 76.8 billion Dollars in 2008 down to 41.7 billion in 2009. At the same time, new Nigerian state debt increased to 6 per cent of GDP. This caused the government to announce several privatisation schemes in order to reduce some of the new debt which meant selling off the“family silver”(EIU 2009: 8).

Such negative developments at the economic level also meant that Nigeria's population was severely affected by the crisis. There is no exact empirical data available to date, but it is certain that the already low proportion of public spending on social security, education, and health has been reduced, it had increased over the previous five years. Additionally, experience with previous cuts in oil prices show that the average state budget also falls in parallel to the declining oil price - the British Overseas Development Institute estimates a drop of about 4 per cent (ODI 2009: 12).
Remittances will also barely be able to counteract this development, judging by the present trends – with more than 10 billion Dollars they constitute an important source of income: having increased for more than ten years. In 2009, remittances to Nigeria did not increase, but decreased for the first time in five years - they fell by 4 per cent in comparison with the previous year (2009a). Consequently, Nigeria's already desperate situation has been clearly aggravated anew by the crisis. Positive development approaches, such as economic growth in the agricultural sector suffered damage. The state's counter-measures could actually stabilize the financial system but could not entirely mitigate the economic effects of the crisis.

3.4. India

India is considered to be one of the economic big powers of the future, and before the crisis it experienced extremely high growth rates: the economy grew on average by more than 8 per cent between 2003 and 2007 (IMF 2010). India's banking sector, which is comparatively strongly regulated, did not participate in the speculative activities on the international financial markets. When the bubble burst, India was in quite a favourable position: the economy was prospering and the Indian financial system managed to remain stable despite the crisis (ICRIER 2009: 1, Bank of India 2009: 4). Nevertheless, the crisis was rapidly transferred to the Indian economy in Autumn 2008. Even though India's economic growth began to increase again soon after, it will remain below the levels of recent years for some time, and thus also restrict some of the opportunities for the country's development (IMF 2010).

The first effect of the crisis on India consisted of a reversal of international cash flows which had already started from the beginning of 2008: between January 2008 and February 2009, a net amount of 13.3 billion US-Dollars was taken out of India – in contrast to a net influx of 17.7 billion Dollars in the year 2007. The Indian stock exchange – where many international investors had deposited their money – collapsed as a result of this: in October 2008, the main Indian stock market index, NSEI, fell by nearly 60 per cent from its peak value in January of the same year (Yahoo 2010).

Together with the cash flow out of India, the credit conditions for Indian companies on the international market deteriorated: loans from abroad fell off rapidly. A classic liquidity crisis followed – Indian companies and private customers experienced increasing problems in obtaining credit. At the same time, the trade sector crashed: India's imports and exports decreased massively in the second half of 2008, after they had even increased in the first half of the year (ICRIER 2009: 3).

The fall in of trade affected the industrial sector especially, and production was reduced strongly. This economic downturn hit the population mainly through an increase in unemployment. The number of employees dropped by 3.0 per cent in Autumn 2008. At the same time, wages were reduced in many areas. Taken together, these developments led to a decline in private consumption – and this lead to a further weakening of India's domestic economy (Bank of India 2009: 75).

The Indian government tried to counteract the crisis by easing monetary policy and with several stimulus packages. The Central Bank reduced interest rates in Autumn 2008, and thus loans were considerably cheaper. It also eased restrictions on banks, so that these could retain less assets as security and lend more capital to companies. A part of the lost credit from abroad could be absorbed through these measures. At the same time, the Indian government adopted three stimulus packages, which also included an employment programme for rural areas, subsidies for the export industry as well as a significant increase in wages for public servants. Together, these various additional outlays amounted to 5.7 per cent of GDP - about 60 billion US-Dollars (ICRIER 2009: 6).
These measures could still not prevent a collapse in economic growth: in 2009, growth only amounted to 5.1 per cent, nearly two points less than in the previous year and four per cent less than 2007. This low is supposed to be reversed again in 2010 already, according to IMF forecasts – the Indian economy is expected to increase to a growth of 6.5 per cent in 2010 (IMF 2010b).

The effects of the crisis, however, will not be overcome for a long time: the Indian economy will remain below pre-crisis levels for some time. Since India, because of population growth, needs a high growth rate for development. Consequently, unemployment will remain high. Additionally, the stimulus packages have lead to a large increased in India's state debt: after the deficit had decreased over the previous five years, it increased strongly again in 2009 and will continue to rise until 2012, according to forecasts by The Economist (EIU 2010).

Through its direct effects, together with the counter-measures adopted by the Indian state, the global financial crisis has imposed a burden on India that will place a strain on its social and economic development for several years to come.
3.5. South Africa

South Africa, the largest economy in Africa and the only G20 member of the continent, was exhibiting positive developments before the crisis. In 2007, the high unemployment rate decreased for the fourth time in a row. Economic growth was at more than four per cent over the last four years. The financial sector was not involved in speculation with US subprime loans (EIU 2010, IMF 2009a: 19).

Nevertheless, South Africa was very severely affected by the crisis and the country suffered a recession (IMF 2010a). The fastest route of infection in South Africa was also via portfolio investment. Foreign Direct Investment remained stable despite the crisis, but the Johannesburg Stock Exchange (JSE) lost more than 50 per cent of its value between January and October 2008. Even if Foreign Direct Investment was not so strongly affected, it also decreased significantly during the crisis (South African Reserve Bank 2009:12). Since then, the stock exchange has recovered but it still remains a 33% below its highest level in Winter 2007 (Bloomberg 2010).

The crisis started to affect South Africa's real economy just when the share market was already recovering. South Africa is a country rich in resources, and its export boom had already started to slow down in 2008. However, in it 2009, it went into reverse because of the decline in global demand. The decreasing oil and food prices did provide some alleviation for the South African economy because imports became cheaper. This effect was overshadowed by the decline in exports and falling prices for South Africa's export goods, especially commodities. At the same time, credit conditions for South African companies and households became more difficult.

Altogether, these factors led to a decline in domestic demand, South Africa's weak point in its economic growth. The growth rate amounted to 3.1 per cent in 2008. It was reversed in 2009 and the country slid into its first recession since the end of Apartheid in 1994. The economy shrunk by 2.1 per cent (IMF 2010a). At the same time, unemployment started to rise again. Half a million people lost their jobs in South Africa from the beginning of 2009. That is a severe setback for the efforts of the government to reduce the extremely high unemployment rate. This increased by more than two points to a total of 25 per cent (EIU 2010).

On the one hand, the South African government reacted to this development by slightly easing monetary policy, especially by reducing the prime interest rate. On the other hand, the government adopted a comprehensive stimulus package amounting to 787 billion South African Rand (55 billion Euros), to provide financial support for pivotal companies and extensive investment in infrastructure (Reuters 2009, IMF 2009a: 8).

Forecasts suggest that these anti-cyclical measures, together with the improvement in the global economic climate, will allow South Africa's economy grow again from 2010 onwards: The IMF expects 2.4 per cent growth for the year 2010 (IMF 2010a). A return to the values prevailing in the years before the crisis is not anticipated even by the most optimistic of forecasts.

Correspondingly, only a small recovery in the South African labour market can be expected. At the same time, the fall in tax revenue caused by the crisis, combined with the costs of the stimulus package have burdened South Africa with a rapidly increasing public debt. Public debt was reduced five years in a row before the crisis, but in 2009 it increased again by 5.2 per cent to 36 per cent of GDP. Estimates suggest that this trend will continue for several years, so that South Africa's public debt will reach 47 per cent of GDP in 2014 (EIU 2010). Consequently, South Africa will still be suffering the effects of the crisis for many years to come.
3.6. China

At first glance, China's economy seems to be completely unaffected by the crisis. Economic growth still was at 8.5 per cent in 2009 in China at the height of the worldwide crisis, and forecasts are already expecting two-digit growth rates for 2010. Nevertheless, the crisis has hit China's economy hard, although China was not in any way involved in the gambling on the financial markets. Around 2000, its mostly still state-owned banks decided not to participate in the speculative trade in derivatives and other complex financial products, since they were considered to be too risky (FT 2009b). Following this, they remained practically unharmed when the speculation bubble burst. The Chinese financial system is only slightly integrated into the world financial markets – and the economy is not dependent on international financial institutions.

Nevertheless, China was also affected by the crisis and suffered a downturn. The stock market practically collapsed between October 2007 and October 2008. Enormous amounts of capital had flowed into China from Summer 2006 to October 2008. The Shanghai Composite Index increased nearly six-fold in value. When the crisis began to loom on the horizon of US financial markets, this development was reversed: the Shanghai Composite Index lost 70 per cent of its value in the period between October 2007 and October 2008 (New York Times 2010).

The crisis also reached the country's real economy when the Chinese stock exchange was at its lowest level following the bankruptcy of Lehman Brothers in September 2008. It hit the weakest point of its economy, the export industry, which accounts for nearly a third of GDP. This sector had been expanding exponentially for decades. It grew by more than twenty per cent on average in the ten years preceding the crisis. Exports only grew by barely ten per cent in 2008 and economic growth was reversed for the first time in 2009, shrinking by nearly a tenth. Exports are expected to increase again from 2010 onwards, according to The Economist forecasts. However, these forecasts suggest that the increases, which are expected to be between 5 and 9 per cent between 2010 and 2014, will remain below pre-crisis levels (EIU 2010).

Nevertheless, China's economy has remained remarkably stable. In 2008, economic growth actually decreased by 4 percentage points compared to the previous year, and fell back again by half a percentage point in 2009 – but it still remained at a level of 8.5 percentage points, a value of which most emerging economies and developing countries can only dream (IMF 2010a).

The fact that Chinese economic growth turned out to be so resilient towards the crisis, was due to massive intervention by the state. By easing monetary policy, The state ensured that the financially well-equipped banks could pump credit to the amount of billions into the economy. The Industrial and Trade Bank ICBC alone issued additional loans of more than 90 billion Euros in the first six months in 2009 – which is equivalent to the GDP of New Zealand (FT 2009b). The government also adopted a gigantic stimulus package amounting to 460 billion Euros (Tagesschau (German TV news) 2008).

The main points of this programme are extensive investment in infrastructure, occupational re-training for migrant workers, as they are particularly affected by the crisis, as well as extensive subsidies for research and development were pumped into the economy. A success of this programme was the short-term changes in the structure of economic growth. Domestic demand was strengthened to such an extent that compensation for the decline in exports could be largely achieved as a result of this significant investment (World Bank 2009b).

The mid-term and long-term effects of the counter-measures that the Chinese government adopted because of the crisis cannot be determined at this point in time. It is not yet clear whether it will be possible to strengthen domestic demand to such an extent that economic growth is less dependent on exports. Equally, it is not yet apparent whether the massive amounts of money which the Chinese banks pumped into the economy will themselves cause
a dangerous bubble in the domestic economy. However, this does not question the extraordinary success of the Chinese response to the crisis: the counter-measures strongly reinforced China's economy and prevented worse happening. This success cannot obscure the fact that Chinese society was heavily affected by the crisis. Wage increases dropped because of the crisis. At the same time, tension on the labour market intensified. There is hardly any reliable data available on the labour market. However, studies on individual segments of the labour market show massive job losses in many sectors. About 15 per cent of the large number of migrant workers lost their jobs - about 20 million, according to a Chinese agricultural ministry analysis. 11 million had still not found a job by March 2009 (World Bank 2009a: 5). Consequently, China managed to avoid still greater devastating effects of the crisis because of its good economic starting point, its closed financial system and because of the rapid anti-cyclical measures adopted.
4. The Systemic Origins of the Crisis

Even if the origins of the crisis lie in the North, the causes of its origins is highly relevant especially from the perspective of the South. A suitable therapy is only possible following a correct diagnosis. The NGO development community in the industrialized countries and the actors in the South, governments as well as civil society, will inevitably have to join in the debate on the origins of the crisis. We will briefly look at the main origins of the crash before presenting proposals for reform in Chapter 5.

Discussions on the origins of the crash have provided numerous different explanations and many of them have been discussed controversially. That is not surprising. If we look at the causes, we are looking at the responsibilities of individual actors and groups, as well as vested interests. Questions of interpretation are questions of power.

One of the most frequent explanations is the recurring theme of managers' greed and the wrong incentives created by huge bonuses. The failure of rating agencies and supervisory bodies is also a common argument. Others speak of easy money, because the former head of the US Fed, Alan Greenspan, flooded the world with cheap dollars at low interest rates and thus sustained the bubble. Of course, these explanations are not all wrong. Certainly, there are greedy bankers, supervision definitely failed, and cheap access to money was actually used for speculation.

However, such a massive collapse cannot be explained with a single basic cause. The factors mentioned above – and others - are only individual elements in a comprehensive relationship, an aggregate structure. The systemic interaction between certain business models, of novel practices and instruments with old players such as banks and new players, such as Hedge Funds, as well as the interrelations between politics and financial industry is decisive. The crisis is systemic.

But what is meant by the system? The system of regulation with supervisory bodies, central banks and the IMF? Or the whole financial system? Or does system mean capitalism as such? The following paragraph will try to answer this question.

4.1. Financialisation - A New Variant of Capitalist Development

Every serious analysis of the crisis has to begin with the fundamental change that commenced with the end of the Bretton Woods system with its fixed exchange rates and political agreements. The deregulation and liberalisation of the world financial system, as well as open markets became the mantra of the new era. There were no more limits to the worldwide mobility of capital.

This created a highly integrated, transnational financial market. In the Bretton Woods era, the business of a bank or insurance was mostly directed to the national economy, and now the big financial markets of the world were open. Access to credit, share and bond markets of the huge transnational space made it possible for previously nationally operating players to become Global Players. The financial industry turned into the vanguard of globalisation and dragged trade and production with it. The mainstream of economic science calls this process of creating a new type of financial system financialisation. The financial industry transformed itself from a service provider for the real economy to the dominant sector of the entire economy.

The conventional services are still being provided within this financialisation – mostly for expensive fees. However, the new sources of profit - speculation, arbitrage, securitisation, etc. - are now the financial industry's main business. The amount of assets transacted on the markets grew immeasurably. Three trillion US-Dollar were transferred internationally on each stock market day alone.

The domination of the financial markets over the real economy also affects the factor labour and the social security systems. Even the political system, democracy itself, the position of the trade
unions and all other areas of the society are affected. An epoch-making upheaval. Consequently, financialisation means not only a transformation of the financial system but is a more comprehensive process that encompasses the whole of society. The concept of a reorientation solely in the interests of shareholders, the concept of maximum profit, the way of thinking that is solely concerned with accumulation of assets and wealth are penetrating into all aspects of social life down to daily existence. A new type of capitalist development was created which is:

- generated by financial markets,
- focussed on financial markets
- and dominated by financial markets.

Financial capitalism would mean a historically specific form of capitalism among the many different variants of capitalism, it is significantly different from other variants such as the Scandinavian or Chinese model.

4.1.1. Speculation – the new business model

Speculation does not exist in neo-classical theory, which provided the theoretical justification of financial capitalism. If referred at all, it is dismissed as an out-dated category of a Keynesian or Marxist position. Instead, the phenomenon of speculation described in these theories is considered to be an investment. Investment is consequently everything for which assets are applied, the basis of which is the expectation of achieving a profit at some later in time. According to this definition, there is no difference between building a factory and trading with toxic derivatives. Neoliberals perceive everything as an investment.

In reality, there is a significant difference between investment and speculation. Both start with a future expectation of profit, but then their logic diverges. With an investment in the real economy, a permanent creation of value is made possible. A company is founded (or an existing company is expanded), and in the case of a successful investment, the company is able to generate expanded reproduction through its own means, practically self-supporting and sustainable. The company's profit is permanently generated from the gathering in of the value added.

In contrast, the objective of speculation is to exploit a future difference in the prices of assets. Speculation can be carried out with goods, companies as well as with financial assets. If a farmer, for instance, does not put his potato crop on the market as soon as it has been harvested but waits a few weeks, hoarding it because he expects that the price will then be higher, this is a then case of speculation. No new potatoes are produced. If many potato farmers do this at the same time, then a speculative bubble is created, i.e. the potato price is increased over a six weeks period because supply is short. Speculation can occur with all goods, but there are differences in extent depending on the nature of the object of speculation. After a few months, potatoes will rot and cannot be sold, but there are no such time restriction on gold or black gold (oil). Speculation with whole companies is achieved through the business model of Private Equity Funds (PEFs) as well as by means of company mergers and takeovers (Wahl 2009: 44f.).

Business of this kind offers immense opportunities for profit but also for huge losses. This duality of high potential for profits or losses through speculative trading in the deregulated financial markets has led to a real explosion of new instruments and players in the last decades. Speculation has been and will be around for a long time. It can have a useful hedging function within a capitalist economy. The economy turns into a gambling casino when it becomes excessive: “speculators may be as harmless as a soap bubble in a steady stream of entrepreneurship. But the situation turns serious if entrepreneurship becomes the soap bubble in a

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4 For instance, agricultural producers can protect their future harvest through so-called Futures, a contract that guarantees the purchase of the harvest to a fixed price at a later date. The harvest is then secured against changes in weather and fluctuations on the market, or exporters can insure themselves against currency risks.
stream of speculation. When the capital development of a country is the by-product of the gambling hall activity, work is not likely to be done well” (Keynes 2009 [1936]: 159).
4.1.2. New Players, Instruments and Organisational Forms in the Financial Markets

The new instruments and players have again accentuated the systemic risk on the financial markets. On the one hand, this applies to a new actor on the financial market - the institutional investor who has become one of the main figures of financial capitalism. On the other hand, it applies to innovative instruments such as derivatives and certifications that have become the main tools of the financial industry speculative business model.

The term new is a relative term concerning the institutional investor as a player, since some of these players have been around for some time, such as Hedge Funds, insurance companies and pension funds. However, their role and their importance within the financial system has changed. This has consequences both for these institutions as well as for the functioning of the system as a whole. A type of player has emerged who can be summarized as an institutional investor.

The most important new characteristic is the institutionalisation and professionalisation of the ownership function. Even the smallest share price differences and other opportunities for profit are detected worldwide with the help of complex mathematical models and the newest data processing and communication technology and then exploited by leverage. This means that the profits were multiplied through the application of a lot of borrowed capital, which the big players on the financial markets always manage to obtain without any problem, thanks to deregulation and liberalisation – but the risks and losses are also multiplied if something goes wrong. Hedge Funds carried out their speculative operations with up to thirty to forty times their own capital. A spectacular bankruptcy occurred in 1999 because of this kind of leverage. The Long Term Capital Management Fund could only be saved by means of an extraordinary bailout with 40 billion USD by the Clinton administration and a chain reaction was prevented. No lessons were learned from this case.

The most important institutional investors are investment banks and investment funds, from the public mutual funds to Private Equity and Hedge Funds as well as insurances and pension funds.

Of the 78.7 trillion USD worth of assets worldwide in 2005, 55 trillion, i.e. 70%, were managed by institutional investors. Of these, 20 trillion were held by pension funds, 17 trillion by insurance companies and 18 trillion by investment funds (Wahl 2009: 41)

The turnover speed of such assets has increased dramatically because of the rise of such business practices. The expectation for profits were driven higher and higher as a result of competition among institutional investors,. The behaviour of the individual investors became more hazardous and focussing on short-term returns became stronger. The systemic risks increase accordingly.

One phenomenon which acted as an amplifying factor is the herding- or pro-cyclical behaviour of the players. Of course, this factor is not considered exist in neo-classical theory, because market participants in that world are supposed to be guided by rational expectations.

To a certain extent, the players on the financial market did actually acknowledge the increasing risks that their speculative practices entail. Consequently, they have been seeking ways to secure their profits. A large proportion of the innovations in the construction of certain financial tools were applied as precautionary measure against risk. This is the famous hedging that is supposed to fence in risks just like a hedge. Since they believed that the distribution of risks over many market participants would minimize risk and make it manageable, risk was recreated and grew ever larger, which was the very thing that they wanted to protect themselves against. In reality, the risk had not disappeared, it was only hidden – as the crisis has very clearly shown.

Countless new tools were created or existing tools expanded in the course of this trend towards hedging risks. The main ones are derivatives and securitisation (certification) of loans.

These tools were originally invented as a form of insurance against natural (weather, poor harvests, etc.) and economic risks (for instance fluctuations in currency exchange rates) and as such they were quite useful. But now the world of derivatives is miles away from its origins and today it mainly serves sophisticated practices for making profit.

The securitisation of loans is extremely important to the understanding of the current crisis. The
bank provides money to a debtor, receives interest rates and at the end of the term the borrowed money is paid back in the traditional cycle of credit. The debtor-creditor-relation was permanent and there was a mutual – even if usually asymmetrical – dependency. Securitisation now means that the bank turns the loan into one or several securities and then sells these papers. The purchaser can also sell the paper on again. The loan has become a tradable asset that is now subjected to the ups and downs of the stock exchanges, just like other assets. Additionally, loans were split up and repackaged again to form new synthetic products, the so-called Collateral Debt Obligations (CDOs), and nobody could judge their origins or their potential risk.

Derivatives can be added to these papers, for instance, to secure against the risk of non-payment. These are the notorious Credit Default Swaps, that became known with the crash as toxic papers. Companies were specially formed for the purpose of trading in these derivatives – or outsourced from the big banks – and relocated outside official book-keeping to the realm of unregulated and uncontrolled shadow banks, in order to place them outside banking supervision. These so-called special purpose vehicles were no longer intended to secure against default but to speculate for especially high profits.

Another component of the system consists of the rating agencies, which were supposed to provide the speculators with overview and insight in view of the increasing complexity of these tools. Their rise to prominence is a result of the increasing complexity and lack of transparency of the whole system. In the end, they only offered an illusory security and became part of the problem. The rating agencies understood about as little of the system as all the politicians, bankers and economists, who considered the system to be as invulnerable as Captain Smith thought the Titanic was a hundred years ago.

This new variant of capitalist development was completed with dozens of tax havens and offshore centres with their fiscal secrets and the absence of any significant regulation and supervision. Liechtenstein, Switzerland, the Isle of Man, the Bermudas, the Cayman Islands and all the other jurisdictions, as they are shamefully called within the financial community, make up the twilight zone between legality and open crime. They are not only used by tax evaders, dictators, terrorists, drug dealers and women traffickers, but are also used gladly by large banks, fund managers and other players on the financial market (Palan et.al. 2010).

Whereas the developing countries are only indirectly affected by derivatives, Hedge Funds and other so-called "innovations", tax havens and offshore centres have immediate effects on development policy: they encourage tax evasion and capital flight by domestic elites and transnational corporations. It is estimated that the economies of newly industrialised and developing countries suffer losses amounting to about 350 to 500 billion USD because of tax fraud (Baker 2005: 172).

4.2. Where Financial Market Capitalism Leads to

It is this set up of new institutions, instruments and business models that has not only profoundly transformed the financial system but has also changed economy as a whole. The financial markets have become the centre. The entire economy is caught within the gravity field of this hub, and - as we have seen at the least during the crisis - the whole of society.

This transformation has led to a greatly increased differentiation and depth in the financial markets, and an inconceivable liquidity has been created and consequently new financing opportunities for big business in the real economy, as well as a pronounced increase in financial assets (see Box 2). The main players of financial market capitalism like to praise these points as increasing efficiency and therefore as the attractions of the system.

On the other hand, there are immeasurably greater disadvantages:

- The systemic instability of the financial system has become unmanageable.
- This has destabilised the entire economy because of the importance of the financial sector,
• Instability is now a global problem, since national economies are now so interdependent because of globalisation.

• It had become a gigantic redistribution machine even during periods when the system functioned without crises. The rich became richer, poverty returned to industrialised countries, differences in income became increasingly unequal. Even the middle classes were under pressure, precarisation started to spread. The social nets were full of holes, the social security systems were cut, benefits were reduced or privatised. Economically vulnerable parts of the population were not only further marginalised, their susceptibility to crises was increased drastically. Today there are millions of pensioners whose private pension has plummeted or has been destroyed completely. Nearly a quarter of the capital saved in pension funds, a sum total of about 5.4 trillion Dollars, was lost due to the crash in 2008 (Antolin/Stewart 2009:4)

• The redistribution from those below to those above and from public to private is not only an effect of financialisation but also one of its prerequisites. Because that part of the total social product which is denied to the workers is used to increase the mass of capital that is seeking added value on the financial markets.

• The crash threatens to accentuate the redistribution effect unless the transfer of the effects of the crisis on to the general population is prevented.

• Finally, the influence of the financial industry has infiltrated democracy and undermined it. Long before the crisis, the threat of highly mobile capital to take the exit option, i.e. the possibility of withdrawing capital over a very short period, made governments amenable to the wishes of the speculators – even if these had never thought of withdrawing. Even ten years ago, the then CEO of the Deutsche Bank said: “Investors no longer have to be guided by the opportunities for investment that their governments offer them, instead the governments have to be guided by the wishes of the investors“ (Breuer 2000). And from the government's perspective, the former German Foreign Minister confirms: “We cannot adopt policies contrary to the financial markets and disconnect ourselves from the rest of the European and global economy“ (Fischer 2000).

• More emphatically, the crisis clearly showed that the sheer size of the financial industry constitutes massive potential for blackmail. The concept of too big to fail showed that the whole of society is dependent on banks even as they collapsed. The financial sector has become a power factor outside the least legitimization. A significant change can only occur if this power is crushed.

Box 2: The Rapid Increase of Private Financial Assets

The development of private financial assets can be seen in the World Wealth Report, which was published by the consulting company Capgemini and the investment bank Merrill Lynch (which went bankrupt in the crisis). It shows the capital assets of HNWIs (High Net Worth Individuals) who are usually not specifically listed in the statistics of the World Bank, UNO, OECD, etc., because statisticians consider this group of people to be too small. The HNWIs are persons with liquid assets – i.e. excluding real estate and tangible property – of more than 1 million US Dollars. Between 1996 and 2007 their capital wealth has increased from 16.6 trillion to 40.7 trillion USD worldwide, an increase of 145% (Merrill Lynch/Capgemini 2008). At the same time, the number of these persons increased from 4.5 to 10.1 million. These 10.1 million HNWIs are 0.16% of the world's population, but manage financial assets that are the equivalent of 1.5 times the GNP of all newly industrialised and developing countries in 2007 - which includes China, India, Brazil, etc. - altogether 28.7 trillion USD.

Of course there are several reasons for this growth, but the report points out that the main cause of this fast growth lies in the new instruments on the financial markets.
4.3. The Role of Global Imbalances

Just as the national economies are becoming increasingly intermeshed because of globalisation, the problem of global imbalances is becoming progressively more urgent. These imbalances are the strong asymmetries between countries and regions shown by important macro-economic or social indicators. The difference between poor and rich countries is one such imbalance, but there are also differences in relation to foreign currency reserves or capital flows, especially trade balance deficits.

The imbalances are to be found in very different sectors. Hence their origins, the forms they take and their effects are also very different. However, they all have one thing in common. And that is that the imbalances constitute a field of conflict which will sooner or later tend towards a crisis-shaped dissolution if not dealt with in time.

When global imbalances are discussed in relation with the financial crisis, it is usually in terms of current account deficits or surpluses\(^5\) of large economies. The main reference is to the US as the largest deficit country and China, Japan and Germany as the biggest surplus countries.

The relation between the USA and China is at the centre of the problem. The US has been accumulating an increasing deficit, especially in their trade balance, from the beginning of the 1990s. The US deficit amounted to 700 billion USD in 2007, the year before the outbreak of the crisis (US Census Bureau 2010a), and thus equalled 5.0 % of GDP. This means that the country imported 800 billion USD worth of goods more than it exported. The greatest proportion of US imports is coming from China, who realised a surplus amounting to 11.7% of its GDP in 2007). The largest part of these exports was to the US, so both economies are inversely related to each other in this issue.

The deficit was paid with US bonds which were mainly purchased by the Chinese Central Bank. China then acquired a historically unprecedented stock of foreign currency of about 2.4 trillion USD in the year 2009 (FTD 2010a). In other words, the USA has incurred debts with China in order to finance their own consumption, especially the purchase of Chinese goods. This situation is actually in China's interest, since the country finances a large part of its own growth and development with its exports to the US. So it could prove to be very difficult to dismantle this imbalance.

How does this relate to the crisis? The US is interested in low interest rates so as to finance the deficit. Otherwise the debt burden would be too great over the long term, even for the US. However, the low interest rates have the "side effect" of flooding the monetary market with cheap money, and this spurred real estate speculation and all other speculative business models. At the same time low interest rates permitted high consumption by the US population, even though the wages in the USA were stagnating (FES 2006). US-Americans were consuming far beyond their means and managed to achieve a negative savings rate of 1% even in 2008, the year of the crisis. In comparison, the Chinese are living below their means. Domestic demand in China amounts to only 64% of GDP (NSBC 2010), in the USA it is at 87% (US Census Bureau 2010b).

This imbalance is related to the global key currency and reserve currency problem. The US dollar is still the global reserve currency. For the USA this entails the advantage that its debt is accumulated abroad in its own currency and it can also manage its foreign trade in its own currency. The US is the only country in the world with this privilege. The US is not exposed to any foreign currency risk and has lower transaction costs than any other country which incurs debt abroad or deals in foreign trade.

\(^5\) The current account of a country is results from the balance between imports and exports of goods, services, remittances and official development aid.
Additionally, a mechanism that usually affects highly indebted countries does not apply to the US: the devaluation of the domestic currency. Since the dollar is the global key and reserve currency, and still is the number one currency used for capital reserves, even for non-Americans, the dollar was not devalued in the crisis. Structural changes in the economies that cause global imbalances are needed if they are to be dismantled. Such structural changes may be very extensive and could not be achieved overnight. Consequently it is not surprising that one first tries to blame the other side with demands being made on each other. For instance, when the US demands that China make the Yuan freely convertible, since the US considers it to be undervalued, China responds with the proposal to replace the dollar as reserve currency with a neutral accounting unit, such as the Special Drawing Rights of the IMF.

A similar discussion has started in the EU as a response to the Greek debt crisis. Several EU countries, such as France, have criticised the German trade surplus because it is achieved at the cost of its trading partners in Europe. Indeed, Germany, with its harsh neo-liberal reforms, has weakened the factor labour and cut social benefits to such an extent that the German export industry has acquired considerable competitive advantages by these means. At present, nearly 50% of German GDP is accumulated through the export sector, which has thus created an extreme imbalance, and this is also from the point of view of the domestic economy. Dismantling this imbalance will require some painful adjustments, especially for capital. Because the German economy will only be able to give up its neo-mercantilist orientation by increasing domestic demand. Wages and benefits would have to be increased, and the fairness of distribution improved. Dismantling the foreign trade imbalances would actually be in the interest of the wage-earners and precarious part of society.

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6 The popularity of the US currency for reserve capital also has non-economic reasons, such as the significance of private property in the American consciousness and the military strength of the country which may be used to protect private property when necessary.

7 And Chinese exports are very cheap and competitive because of this.

8 The Special Drawing Rights are an artificial accounting unit, its value is calculated on the basis of several currencies.
5. Alternatives – Shut down the Casino or Make it Safer?

The crisis has spurred a very intensive discussion on reforms. Hundreds of proposals are circulating in the media, at expert meetings and in political commissions. Just like the analysis of the causes is disputed and reflects an open or hidden clash of conflicting interests, the debate on alternatives is unclear and full of many contradictions.

The most important multilateral political bodies where reforms are being discussed and to some extent concretely elaborated, are the G20, the Basel Committee on Banking Supervision, the UN Commission on Financial Reforms chaired by Joseph Stiglitz, the Financial Stability Board and the EU. Furthermore, there are attempts for reform at national level, especially in the US.

So far (at the beginning of 2010), however, only few practical steps have been made. Some measures have been initiated, for instance several EU directives, such as on the regulation of Hedge Funds and Private Equity Funds, on derivatives, on rating agencies and on improving supervision. The Basel Committee is preparing new standards for equity capital precautions and risk management, and the Stiglitz Commission has presented a comprehensive reform package.

On the whole, there have only been minor ameliorations so far. The financial industry is employing all its power to be up in arms against any kind of substantial reform. In a mixture of being incapable and unwilling to reforms, politicians are not able to stand up to the financial industry's politics of obstruction. And there is not much to be seen to date from social movements, protest and resistance from below either.

Since the reform debate is very confusing, it is best to first formulate a few basic criteria to evaluate the huge amount of individual proposals. These criteria are:

a. shut down the casino, shrink the financial industry and deglobalise,

b. democratic control of the financial markets,

c. redistribution from above to below,

d. guarantee systemic stability.

5.1. Shut down the Casino - Shrink the Financial Industry and Deglobalise

The first basic criterion of this kind is the question whether the casino is to be shut down or to be maintained, maybe made a bit more secure for the players, that is the investors/speculators. If the gambling hall is to be kept running in a modified form, there is likely to be another crash in the short or long term. Therefore, the assessment of the UNCTAD should be supported: „Nothing short of closing down the big casino will provide a lasting solution.“ (UNCTAD 2009a: 60).

This is based on the awareness that the liberalised and deregulated financial markets in their current form have become a history-making factor that is beyond control. This is the factual core of the metaphor of the monster, that the German Federal President and former head of the IMF, Horst Köhler likes to use to describe the financial markets. The belief that the monster could be controllable with adequate risk management has proven to be an illusion.

Keynes already knew this. He was a strong advocate of globalising trade, but at the same time he wanted to keep the financial markets under state control. Better to have several little predators that the nation state as an animal tamer can master with its means of regulation that have grown through centuries, rather than a global monster that nobody is capable of taming. Therefore he suggested that „the control of capital movements, inflows as well as outflows..."
should be a permanent feature of the post-war system“ (Keynes 1942: 9). He wanted „a mechanism for controlling exchange rates even if all payments for ongoing trade should be permitted“ (Keynes 1941: Appendix C). The nation states „should have unrestricted control over capital transactions - inflows as well as outflows – of their citizens“ as well as the right „to prevent unauthorised transactions“ (ibid.).

This actually means that

- the globalisation of the financial markets is to be reversed to a certain extent and that the now largely unrestricted free flow of capital is controlled. This would be a selective de-globalisation;
- the financial sector is downsized. Even the sheer mass of capital alone on the markets exerts an enormous pressure for profit. Basically, there is a surplus liquidity that has to be contracted and redirected to the real economy.

The main issue is to break the power of the financial markets over the real economy and the society and to enable a democratic organisation of the economy, with the guidelines of stability, social justice and ecological sustainability.

Concrete instruments to achieve these goals are, among others, controls of capital transfers, i.e. the restriction and direction of cross-border capital flows – inflows and outflows – according to the needs of a national economy. There are market-related controls of capital transfers, such as the taxation of cross-border capital transactions with a Financial Transaction Tax (see Box 3), depot obligation, 11 or purely administrative controls, such as the determination of maximum amounts or the temporary prohibition of outflows.

Furthermore, the establishment of a strong public and co-operative banking sector is an important part of a strategy that lets democratic politics regain sovereignty over the financial system.

Additionally, the big private banks need to be de-concentrated. If they are too big to fail, they need to be made smaller or split up, until there are no systemic effects if they go bankrupt.

To abolish the asymmetry between the transnationally operating players on the financial market and the possibilities of politicians that are restricted to the nation state framework, multilateral cooperation between governments has to replace national competition. The locational competition gives financial markets the possibility to pit states against each other. Therefore, a kind of Bretton Woods 2.0, of course adapted to the situation of the 21st century, should be established.

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11 The depot obligation requires that a part of capital must be stored at the Central Bank for a certain period, for example one year. Then it is released. This requirement impedes short-term speculation such as Carry Trade or foreign currency speculation or even makes it unprofitable.
Box 3: The Financial Transaction Tax

As a result of the financial crisis, the Financial Transaction Tax (FTT) has become a prominent theme on the agenda for reform. Even leading politicians such as Angela Merkel, Nicolas Sarkozy, and Gordon Brown have spoken in favour of it.

The FTT introduces a tax on trade in all kinds of financial assets: shares and all commercial papers such as bonds, treasury obligations, certificates, derivatives, etc. Other categories of financial transfer, such as day to day payment transactions and the credit system, are not affected. This also applies to interbank transactions, central bank business and the foreign bank transfers of labour migrants.

Basically, the FTT can be compared to the value added tax. Whereas the purchase and sale of each pound of butter and each t-shirt is charged with the value added tax, the trade in financial assets is tax exempt. This represents an enormous duty free shop for all who can afford to shop there.

The FTT allows two birds to be killed with one stone:

a. It would have a steering effect and reduce speculation. A large part of speculative business exploits the smallest exchange rate fluctuations, even in the realm of one hundredth of one per cent. When leverage is applied, i.e. foreign capital is used, then there is already enormous potential for profit if several hundred millions are brought into play, especially if these deals are repeated again and again over a short period.

b. A considerable proportion of these deals would already cease to exist if there were tax rate of about 0.1%, since they would no longer be profitable. The FTT would raise very large amounts of income even with a small tax rate, when one considers the huge turnover on the financial markets. A tax rate of only 0.1% would lead to a revenue of 734.8 billion US dollars worldwide in a scenario where trade volume is only slightly reduced because of the tax. This would amount to 321.3 billion in Europe and 313.6 billion in North America. Even the massive increase in the US budget deficit could be completely paid off within eight years with the income from the FTT. And in an even shorter time in Europe. Additionally, the FTT could provide a large contribution to financing public goods such as climate protection and social justice.

Tax collection would be technically very easy and inexpensive, since all stock exchange transactions are already registered on electronic platforms. A simple electronic labelling tag could forward the tax revenue automatically to the tax office. Tax evasion or tax fraud would be unlikely since dodging the platforms would be turn out to be more expensive than the tax.

The FTT could also be introduced regionally, for instance in the EU or the Euro zone. Social organisations strongly advocate the FTT and are organising campaigns for its introduction (see e.g. www.makefinancework.org).

5.2. Democratic Control of the Financial Markets

A second important criterion for assessing reforms is the criterion of whether a measure contributes to stopping the erosion of democracy caused by the influence of the financial markets.

The following measures fulfil this criterion:

- supervisory bodies should be comprehensively reinforced with legal powers, staffed and properly financed. The financial industry always stays one step ahead in the game for as long supervisory bodies are inadequately staffed, which means that democratic control is impossible.
• The supervisory boards must work close together internationally and thus become more powerful so that they can effectively counter the transnationally operating players on the financial markets;
• all actors on the financial markets are to be subject to control by the supervisory bodies. All forms of shadow banks and off balance procedures as well as opaque business models are to be prohibited;
• over the counter trade must occur via a public institution, for instance a clearing house which can be controlled by the banking supervising body;
• transparency must be secured for all products and business models. So-called innovations need permission from the banking supervision authority and are obliged to pass through an independent impact assessment (such a control board for financial markets exists for manufactured goods and motor vehicles);
• multilateral organisations and bodies such as the IMF, World Bank, G20, etc. must come under democratic control;
• the multilateral governance system must be decentralised and supplemented by strong regional structures;
• labour rights must be strengthened. Anti-trade union legislation must be reversed.
• Employees, trade unions, consumers and other stakeholders need to be given participation rights in entrepreneurial decisions, steps must be made towards economic democracy.

5.3. Redistribute
The system of financial market capitalism has a redistribution dimension of enormous importance, as seen in chapter 4.2. This leads to an accentuation of social polarisation, and the concentration of large financial assets creates permanent pressure for valorisation that contributes to driving the gambling hall. Consequently, a third criterion for assessing financial market reforms is its distributive effects.

Besides instruments such as the FTT, which can have distributive effects by means of its tax revenue, high income and large assets need to be taxed progressively. This not only reduces the pressure for profit by the rich, but also expands the state's opportunities for redistribution with the aid of tax revenue.

At the same time, the privatisation of public services must be terminated and reversed. The services of common interest – health and pension systems, education and the most important infrastructure utilities such energy, water, waste removal, and transport, especially – must be under public control. The enormous finances that are moved in these sectors are make the mouths of every speculator water. But they are too important to society and everybody to be surrendered to private profit. Especially since these are key areas for social and ecological modernisation.

Finally, domestic demand in large surplus countries such as Germany should be strengthened. This would reduce global imbalances and strengthen labour income.

Additionally, the North-South dimension of redistribution issues must be an integral part of reform policies. This means, in particular:
• The neoliberal structural adjustment programmes of IMF and World Bank, which forced the neoliberal model on to many developing countries during the last two decades must be terminated. The crisis has shown that those countries which did not follow or abandoned the neoliberal model, such as China, India, Malaysia – had better possibilities for dealing with the crisis.
• Instead, there should be a plurality of development models, and each country should have the right to determine its own course.
• Liberalisation measures which increase the vulnerability of developing countries must cease. For instance, the pressure the EU exerts on developing countries and newly industrialised economies to liberalise and deregulate their financial services sectors within the General Agreement on Trade in Services of the WTO (GATS) must be stopped.

• The poor countries need fast debt relief. The international loans which they received for anti-cyclical measures to absorb the effects of the crisis must not lead to new debt. They should be given grants in such cases, since these countries did not cause the crisis.

• Trade in agricultural commodities which are necessary for food security in developing countries should be removed from speculation activity. Institutional investors should be barred from access to trade with such futures or other instruments.

• Commitments should be met with regard to those made with regard to transfer payments for development aid not only with respect to the GDP percentage of the donor countries but also in absolute figures. The additional burden incurred through the crisis-induced rise in poverty should be compensated with further payments. The achievement of the Millennium Development Goals by 2015 should be guaranteed.

5.4. Stability of the Financial Market as a Public Good

Stable financial markets are a public good. All measures which contribute to increasing systemic stability, are good and deserve support by society. The proposals presented in the previous chapters of this document also contribute to the stability of the financial system. Additionally, the following measures are important:

• equity capital requirements for banks and all other institutional investors must be increased;
• leverage should be restricted;
• risk management should be improved, and macro-economic risks especially should be integrated;
• Hedge Funds, Private Equity Funds (the so-called locusts) and other highly speculative business models should be prohibited since they do not benefit the national economy, and exclusively serve to enrich and constitute a systemic risk; the benefits that Private Equity Funds allegedly have in providing risk capital, can be performed much better by public development banks;
• strictly regulate the trade in derivatives;
• establish a rating system under public control;
• shut down offshore centres and tax havens with their economic function and abolish banking secrecy with respect to supervisory bodies.

5.5. A Period of Transformation

Of course, the reform programme draft presented here cannot be implemented within a few months, not even within a few years. The formation of financial market capitalism was also a long and non-linear process, and transforming it into another system will not be any different. There will be long-lasting disputes over substantial reforms, with wrong turnings and setbacks.

Over the long-term, however, there is no other way except by overcoming the old system. It does not work, not even by the standards of those who invented it, and even if its advocates will still try to do business as usual for some time – it will fail again.
The length of the transformation process will also depend highly on the pressure from below in society. If the process mainly consists of reforms from above, then it will take longer and the cost to the general public will be high. Consequently, social intervention is indispensable.
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