SEARCH FOUNDATION

Global Crisis Fact Sheet 1

The Global Economic Crisis

The Global Economic Crisis continues to worsen, making millions unemployed, bankrupting companies, sending house prices crashing, and destroying people's savings. The crisis represents the complete failure of three decades of free-market policies that put the interests of big corporations before the public interest. So, why did it happen?

Why did it happen? Deregulation and growing inequality

The immediate causes of the global financial crisis lie in the US banking system, but the longer term causes arise from policies implemented by governments around the world over the last thirty years. Called economic rationalism, neoliberalism, or the Washington Consensus, these policies have removed social regulation designed to protect consumers and workers, have redistributed income to the rich,and promoted huge growth in both corporate and consumer debt.

These policies also assumed that economic growth could be endless, ignoring the history of boom and bust cycles in capitalist economies over the last two centuries. Global inequality also increased, with over two billion people now living on less than US$2 per day.

Governments have cut company taxes, wealth taxes and income taxes for high income earners, and have introduced consumption taxes like the GST, which fall most heavily on low income earners who spend most of their income.

There have also been cuts in government spending on health, education and welfare, and privatisation of many services. But private profits have been guaranteed by continuing government subsidies, as we have seen in services ranging from childcare to toll roads.

Legislation like Howard's Work Choices reduced basic working standards and allowed employers to impose individual contracts on workers, while restricting their rights to join unions and bargain collectively.

The justification for these policies was that redistributing wealth to the rich would result in higher levels of investment and employment, and that benefits would "trickle down" to lower income groups. But they were based on a culture and practice of greed which undermined community values and increased inequality. Executives salaries have exploded. Wages as a share of total income have fallen, and profits as a share of total income have risen.

Growth of the finance sector, 'casino capitalism' and the environmental crisis

Following the Great Depression of the 1930s, in which unemployment reached 30%, many banks collapsed and millions lost their savings, governments introduced regulation to ensure that banks had adequate funds and would not engage in high risk loans or investments. Government-owned savings banks provided for low income savers.

Since 1979, privatisation and deregulation of the banks, and the finance sector more generally, removed these safeguards. Mergers have created giant global banks focused only on short term profits. This led to the "financialisation" of the economy, or "casino capitalism", in which the finance sector as a whole has grown much faster than the rest of the economy,

Capitalism is not working - economic rationalism, also known as neo-liberalism, is discredited.

The crisis was caused by a huge load of debt created to keep up production, consumption and profits, while wages, especially in the USA, were driven down.

The finance sector in the USA, bloated with predatory loans, collapsed and took the world with it - including Australia.

Economy Environment

driven by highly profitable but complex financial products involved in currency trading, futures markets and corporate and consumer debt.

The growth of consumer debt through credit cards, personal loans and mortgages has been highly profitable. Falling real wages and casualisation of work have meant that consumer debt can be the only option for low income earners to maintain living standards.

The 'free trade' agenda pushed by the International Monetary Fund, the World Bank and the World Trade Organisation aimed to expand markets and profits for US, European and Japanese corporations at the expense of local producers everywhere.

The growth of all forms of debt enabled huge increases in production and consumption, which accelerated the global warming and the unsustainable use of resources that has been developing over the last two centuries of industrialisation.

The US sub-prime mortgage crisis

The immediate cause of the crisis was the massive growth of high risk or “sub-prime” mortgage loans in the US housing market, which began after interest rates fell in 2001-2.

Falling real wages and casualisation of low paid work in the US increased the numbers of working poor, often depending on more than one part time job without earning a living wage. Millions of low income Americans, often from African-American and Hispanic communities, had no access to affordable housing as governments cut public housing programs.

Lending to people who cannot afford to repay is known as predatory lending, and had been illegal in some US states. But these laws were repealed in the name of deregulation.

US banks offered mortgages to low income people at initial low interest rates. But hidden in the fine print was a shift to higher interest rates that they could not afford. The banks knew that many people would not be able to continue payments, but they gambled that rising house prices would cover the cost of defaults.

The banks then converted the risky loans into securities, which were promoted and sold as investments with acceptable risks but high interest returns. Ratings agencies like Moody’s and Standard & Poor’s rated these securities as good investments - 'Triple A'.

The deregulation of global financial markets meant these securities could be sold to other banks, local government and pension funds all over the world, including Australia, creating contaminated time bombs in the global banking system.

By 2007, the highest risk sub-prime mortgages were 14% of the total US mortgage market, with a further 10% of the market classified as risky. As the higher interest rates kicked in over 2007-8, millions defaulted, flooding the US market with millions of houses for sale, leading to sharp falls in house prices. Families were left homeless as their houses were sold.

The ratings agencies downgraded the value of the securities. Banks and other investors throughout the world suffered huge losses, leading to bank failures in Europe and the US. Banks stopped lending to each other and to their customers.

With less money available to buy shares, share markets plunged in value, leading to losses for superannuation schemes and retirement incomes. Economic growth has slowed, unemployment is rising, and the US and European economies are now officially in recession. The Australian economy was boosted by the resources boom, but growth is now slowing. We are now seeing rising unemployment and layoffs in retail, mining, manufacturing and other industries. The Great Recession will get worse before any recovery can begin.

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