

# *Global Crisis Fact Sheet 6*

## *Financial Regulation*

Financial sector corporations must take a large part of the blame for the deepening Global Economic Crisis - or 'Great Recession'. Reckless lending, obscene payment to executives, and financial engineering designed to avoid regulation, are all part and parcel of the 'casino capitalism' that led to the crash.

Fixing finance is a vital part of stopping the crisis and creating a fair and green economy.

### **What is the problem?**

Over the last 25 years, financial deregulation and privatisation have created an overgrown financial sector driven by speculative greed and unsustainable debt levels. The giant Western banks, insurance companies, hedge funds, accounting firms, and ratings agencies that have dominated the system, have together driven the world into a Great Recession that may become a Depression.

The highest recorded value of the wages share of total national income in Australia was 62.4 per cent in 1974-75. Since then the wages share has been trending down to be 53.7 per cent in 2006-07. The profits share of total national income reached 26.5% in 2007-08 and this represents the highest share recorded since 1959-60. Depressed wages are a significant reason for the over-reliance on consumer debt to sustain economies.

In the USA, according to Sydney economist Steve Keen, total household debt in November 2008 was 290 per cent of gross domestic product. In Australia, the total household debt has peaked at 165 per cent of GDP. In 1973 the figure was just 45 per cent. For the USA the private debt load is almost twice as bad as it was in the Depression of the 1930s.

The finance industry has pushed housing mortgages, credit card debt, and car loans on ordinary wage earners, and pushed 'derivatives' onto richer individuals, local government, charities, as well as businesses large and small. This became particularly intense in the USA after the 'dot com' share market bubble burst in 2000, and the September 11, 2001, terrorist attacks in New York and Washington. Interest rates were cut to just 1 per cent and loans pushed onto everyone, even people with no jobs and no assets.

Banks themselves sold the highly abstract 'products' to each other and to hedge funds. Some insurance companies then insured these 'products' against failure. They did fail. The Bank of International Settlements reported that as of July 2008, there was \$683,000 billion worth of outstanding derivative contracts, which are not regulated. The fallout from these is yet to hit the global financial system.

The bursting of the US 'sub-prime mortgage bubble' in late 2007 triggered the collapse of this much broader debt load, right across the world, including in Australia.

In 2008, banks crashed in the USA, the United Kingdom, France, the Netherlands, Germany and in many smaller countries. Iceland went bankrupt. Latvia is close to bankrupt.

Banks have become reluctant to lend to each other and greatly reduced lending to business, speeding up the collapse of the real economy. In Australia, banks have also reduced lending, and the resources boom is over.

The International Monetary Fund predicted in April 2009 that the global economy will shrink by 1.3 per cent in 2009. But it reported that in the last three months of 2008, the global economy shrunk by 6.25 per cent on an annual basis, and almost as fast in the first three months of 2009. The rich countries declined even faster, at 7.5 per cent per year, in the last three months of 2008. This means the recession could be worse than the IMF forecasts.

Unemployment is severe in the USA, Japan and Europe. In Australia it is officially at 5.4 per cent. Since a person only has to work for one hour in a week to be 'employed' in the Australian Bureau of Statistics survey, 5.4 per cent is an understatement.

The USA has had a series of 'economic stimulus' packages and 'bank bailout packages', but these haven't worked so far, and the banking system is still not working.

The Rudd government has made popular moves to stimulate consumer spending, and to spend over \$42 billion on public works over the next four years, and to also spend \$43 billion on the National Broadband Network. It has helped banks by guaranteeing deposits up to \$1 million and guaranteeing the loans that the banks themselves make from overseas banks. These are welcome measures but the government still expects unemployment to increase.

### **What can be done to regulate finance and debt?**

The Obama administration in the USA is in conflict with the owners of the big banks who are resisting even mild re-regulation. Instead of writing off their 'toxic assets', these banks are demanding that the US people buy them at inflated prices.

According to US economist Nouriel Roubini, the US banking system has bad assets of over US\$3,600 billion, and capital of only US\$1,400 billion. The government bailout is US\$700 billion. Like many economists now, Roubini insists that the banking system is insolvent.

The public interest is best served by writing off non-performing assets, and thereby wiping out the value of the shares in these banks. The government should then take over the banks to recapitalise then to restore them to their proper role of lubricating the wider economy. Australia should promote this solution.

### **In Australia:**

- create a genuine publicly-owned bank which will be willing to lend to creditworthy customers in all sectors – rural, industrial, commercial, services, housing.
- nationalise any Australian bank that collapses, but don't bail out shareholders.
- run publicly-owned banks by boards which include professional financial experts, government representatives, and also representatives of community sector organisations and elected staff representatives on a charter to serve the public interest.
- regulate finance sector executive salary packages, using the Corporations Power of the Federal Constitution - the same power used for the Fair Work Act.
- sharply reduce international financial speculation by imposing a tax of 0.1 per cent on all financial transactions – a modified 'Tobin Tax' - to regulate the whole finance sector, and to help fund international aid to poor countries. This requires international agreement.
- stop regulated banks and financial institutions from lending for 'derivatives' unrelated to the real economy, and to hedge funds; no bailouts for these speculators.
- legally separate auditors from accountants and banks. Auditing regulations must include criminal penalties for non-compliance. Big accounting and auditing firms have been declaring shonky business operations as 'sound', because of the huge fees they are paid.
- fix currency exchange rates against a new global standard – not gold, not the US dollar, not the Euro, but a new global currency proposed by the United Nations Expert Panel.
- support international moves to make the Credit Ratings Agencies – Standard & Poors, Moodys, and Fitch – independent of the companies which they rate. If these moves go nowhere, then nationalise the ratings agencies in Australia. The Ratings Agencies declared that the 'mortgage-backed securities' from the USA were 'triple A' when in fact they were worthless – because they were paid hefty fees by the banks to promote them.

Produced by the SEARCH Foundation. June 2009.



Social Education and Research Concerning Humanity Foundation  
Level 3, Suite 3B, 110 Kippax Street, Surry Hills NSW 2010  
Phone: 02 9211 4164 Fax: 02 9211 1407  
Email: [admin@search.org.au](mailto:admin@search.org.au) [www.search.org.au](http://www.search.org.au)