

Models of development, the financial crisis and global growth

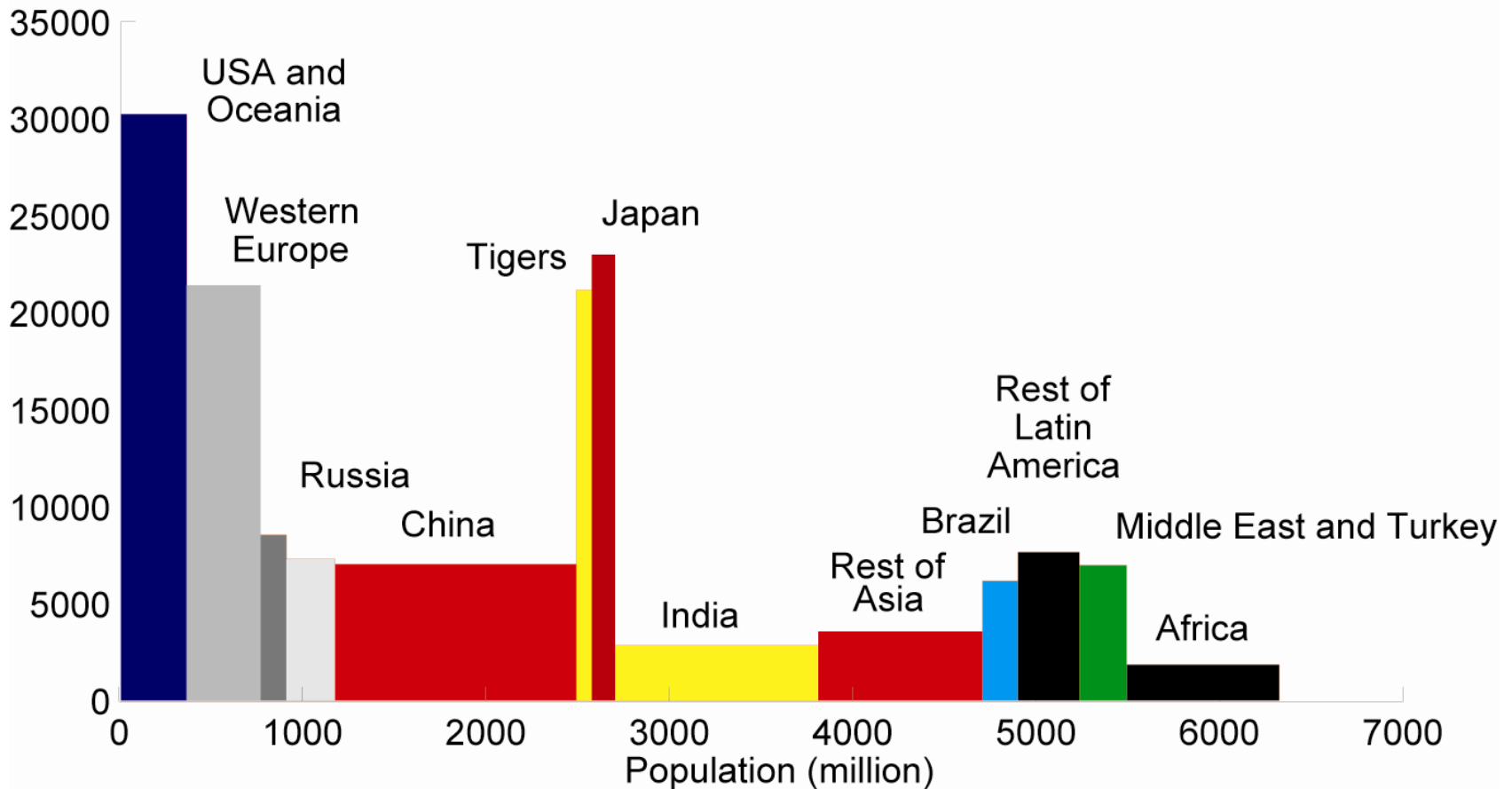
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1 Fundamental principles

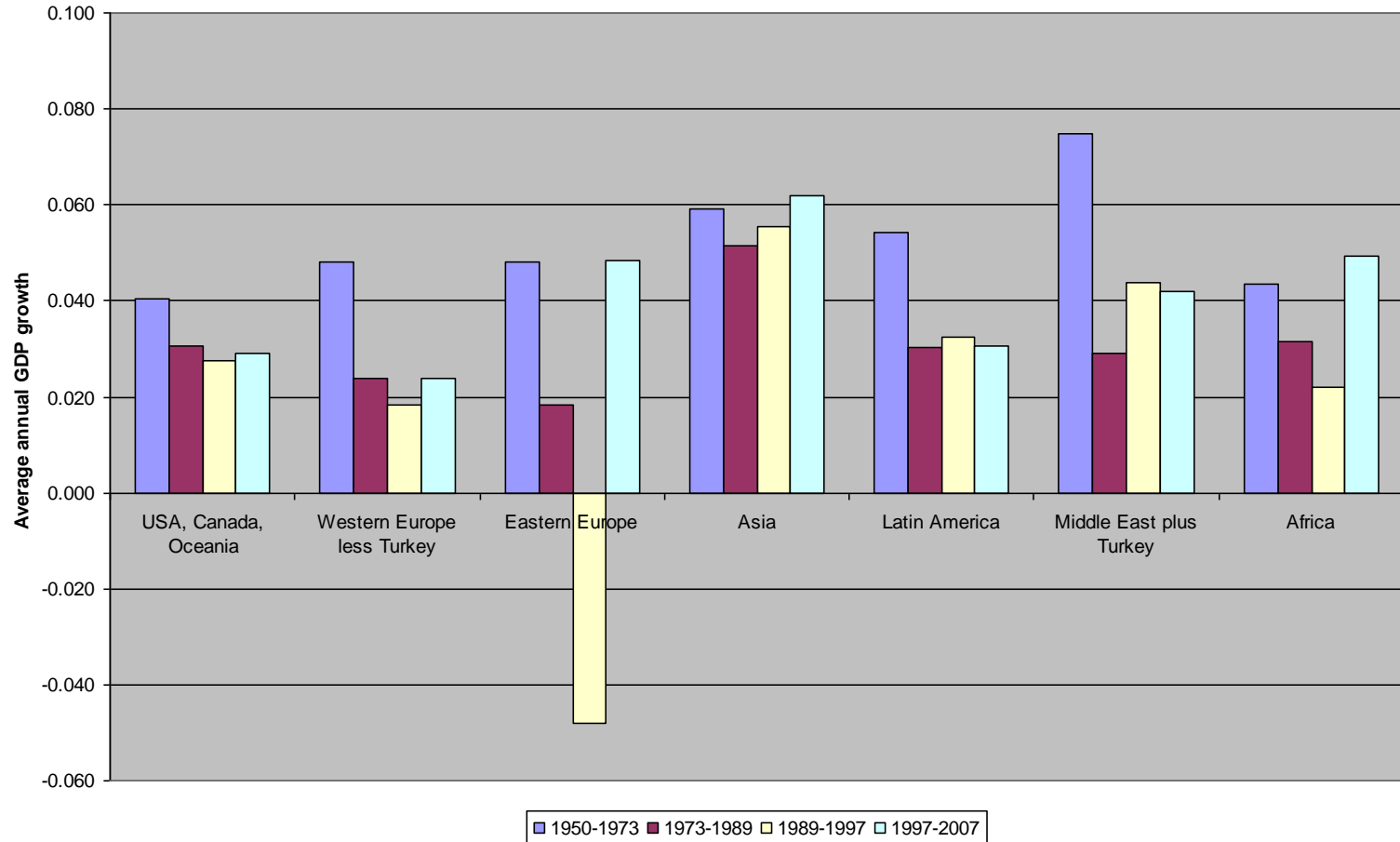
- Differing collective beliefs expressing common good, embodied in specific institutional configurations and partly deriving from legitimate power of sovereign states shape economic trends.
- A succession of institutional configurations and models of development punctuated by structural crises that reflect underlying contradictions and associated disequilibria
- Nature, labour and money (a public good) cannot safely be treated as commodities and subjected to unmediated market mechanisms without destroying them (Karl Polanyi, 1943)
- Market economy and capitalism are linked but not the same
- Capitalism associated with asymmetrical systems of political power (Braudel). Asymmetric integration of varying models of development modifies internal dynamics and generates international/global disequilibria.

2.1 Unequal development

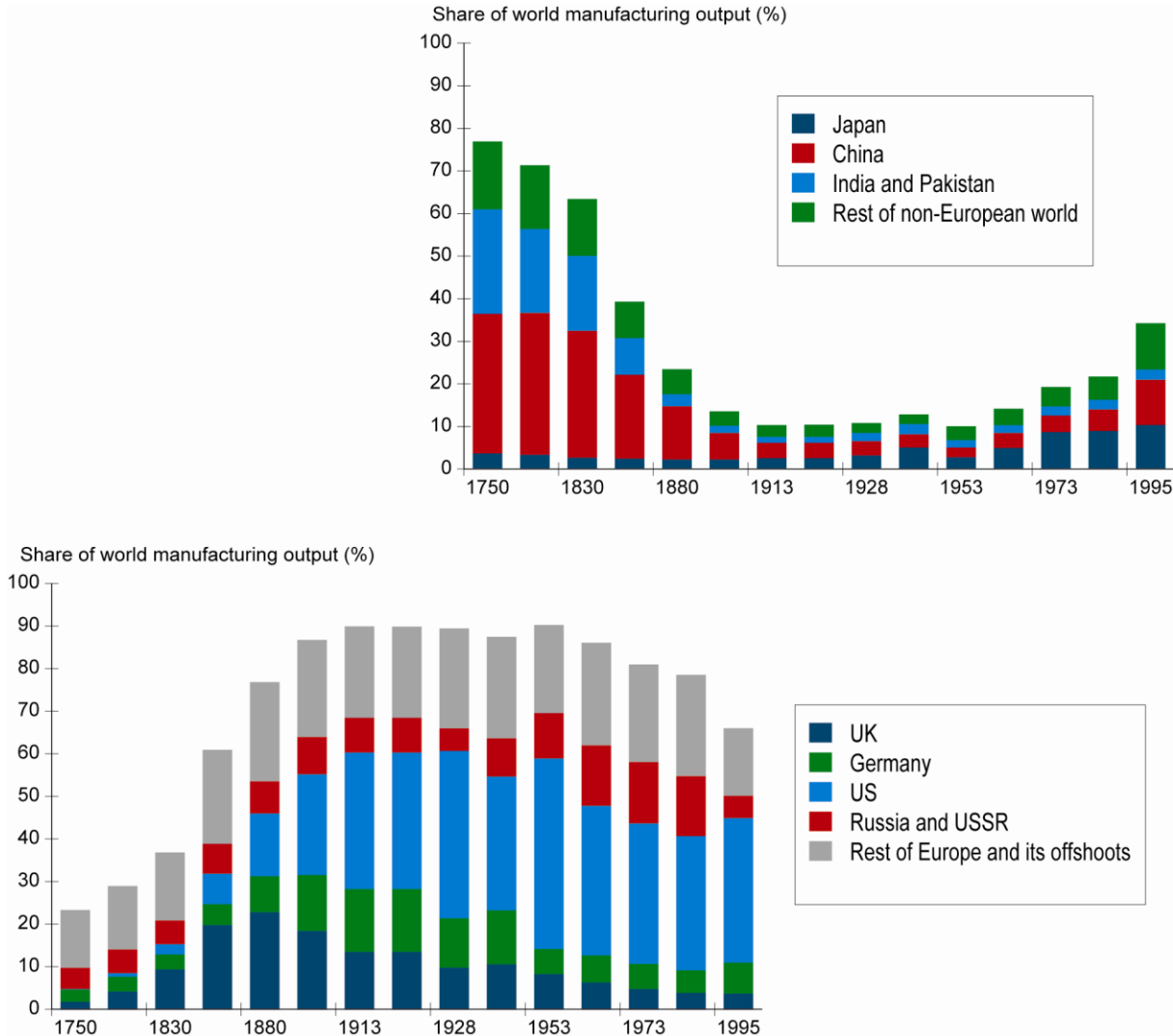
GDP per Capita in 2007, in 1990 GK\$



2.2 Growth deceleration of European settled world and Asian acceleration



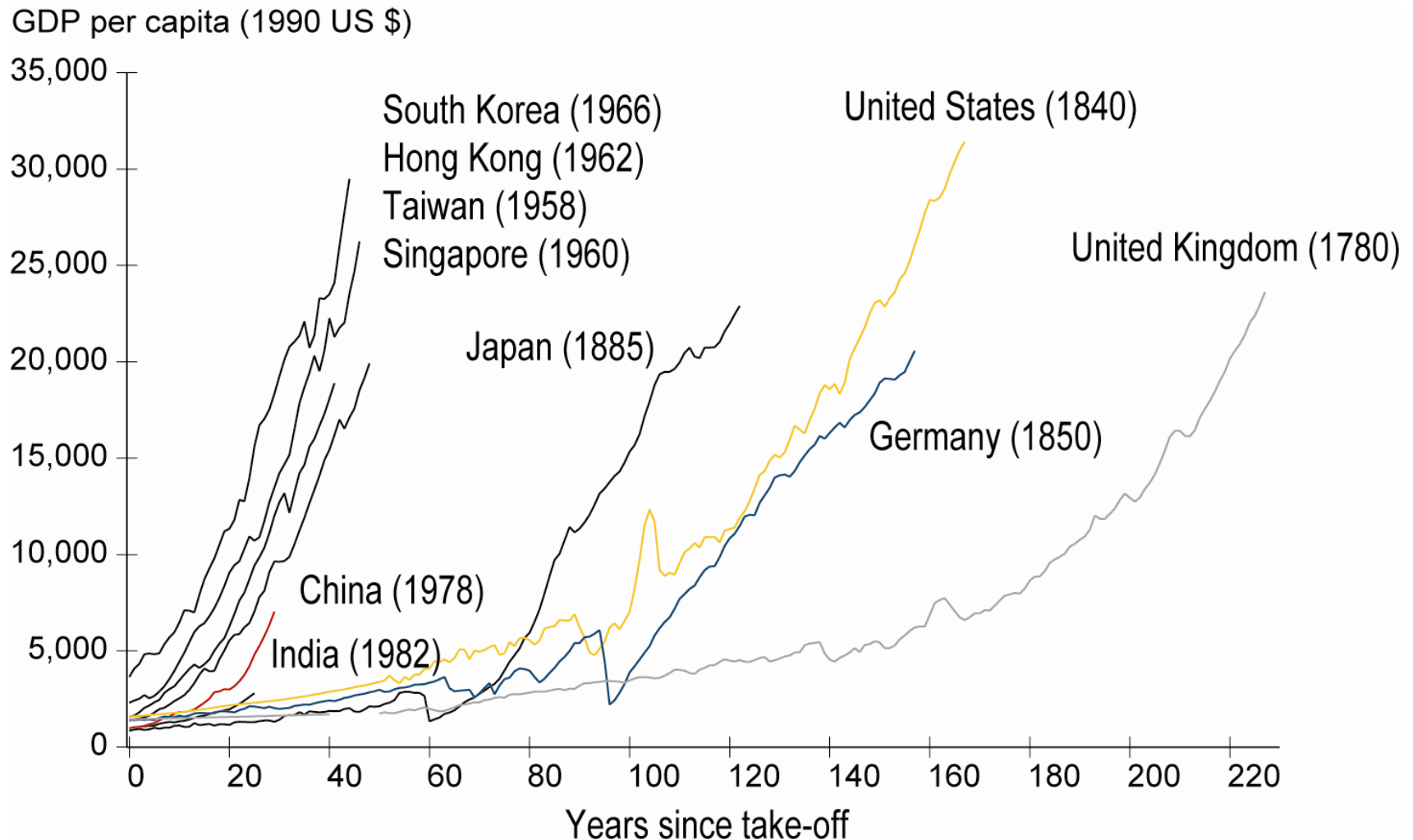
2.3 A new second industrial divide



2.4 A turning point in global development

- The Asian crisis of 1997-8 was the trigger that allowed emerging market economies to escape the (augmented) Washington Consensus: debtors to creditors, competitive devaluations, increase size of world labour force
- China, perhaps with Brazil, Russia and India (BRICs) comprise a group of economies that will lead growth: in 25 years 66 per cent of world GDP, reversing a gap created by industrial revolution, colonialism and imperialism

2.5 China and India: take-off and third wave globalization



3.1 Quests for growth: lean production, the Anglo-American model, dotcom crisis and the financial crisis

- In 1990s successful economies of 1980s of Japan (lean production) and Germany experience crises
- growth of new economy and US/UK
 - constant innovation and generic ICT technologies as growth engine
 - production of ideas by means of ideas relying on human capital investment,
 - commodification of knowledge, information goods
 - market liberalization/de-regulation
 - market finance-driven capitalism
 - shareholder value

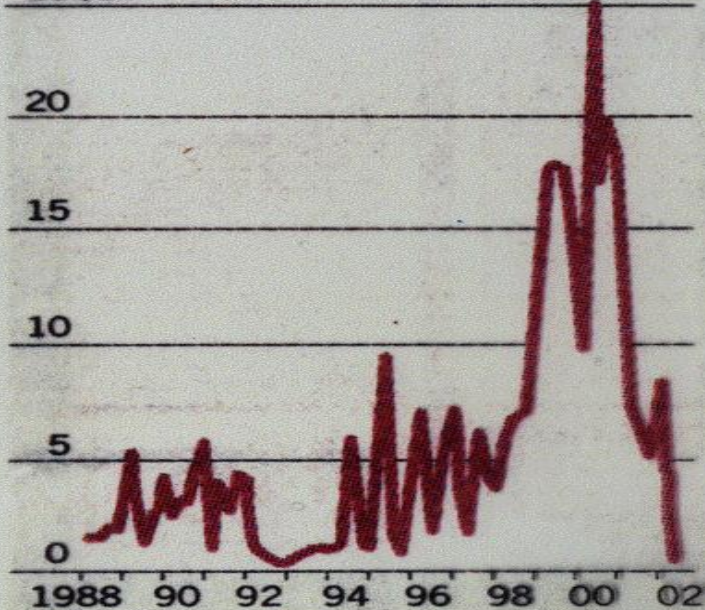
3.2 Dotcom crisis: a reflexive community with self-realising expectations detached from real prospects of profitability

Germany burnt as hi-tech bubble bursts

Merger and acquisitions

Flow from Europe to US
Fourth quarter monthly average

25 \$bn

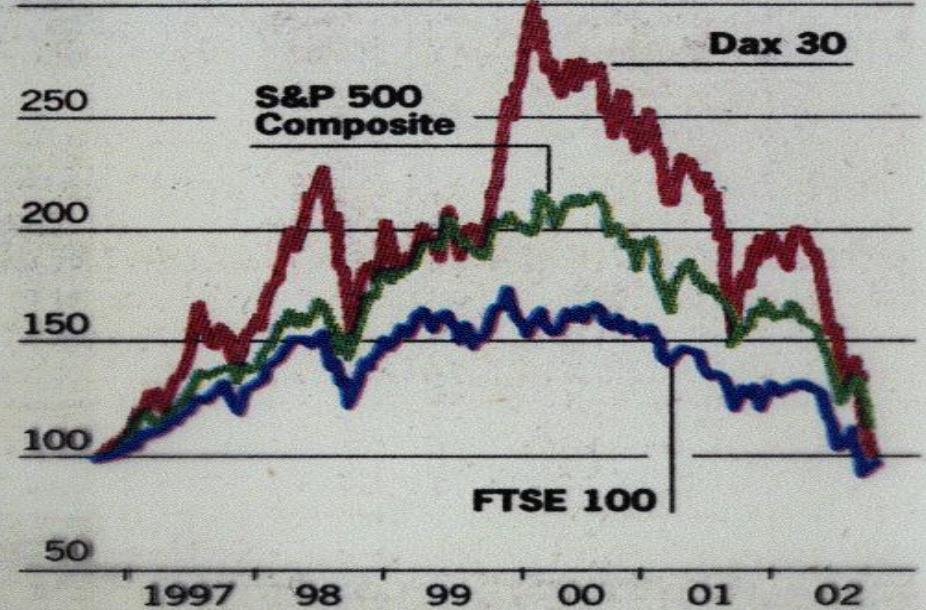


Source: JP Morgan

Stock markets

Index, rebased to 100

300



Source: Thomson Financial Datastream

3.3 ICT and a third industrial revolution?

- 'the new economy has already joined lean production in the museum of innovations that were once supposed to leave an indelible print on the twentieth century but whose effects were in fact frittered away after only one or two decades (Boyer, 2004: 149)

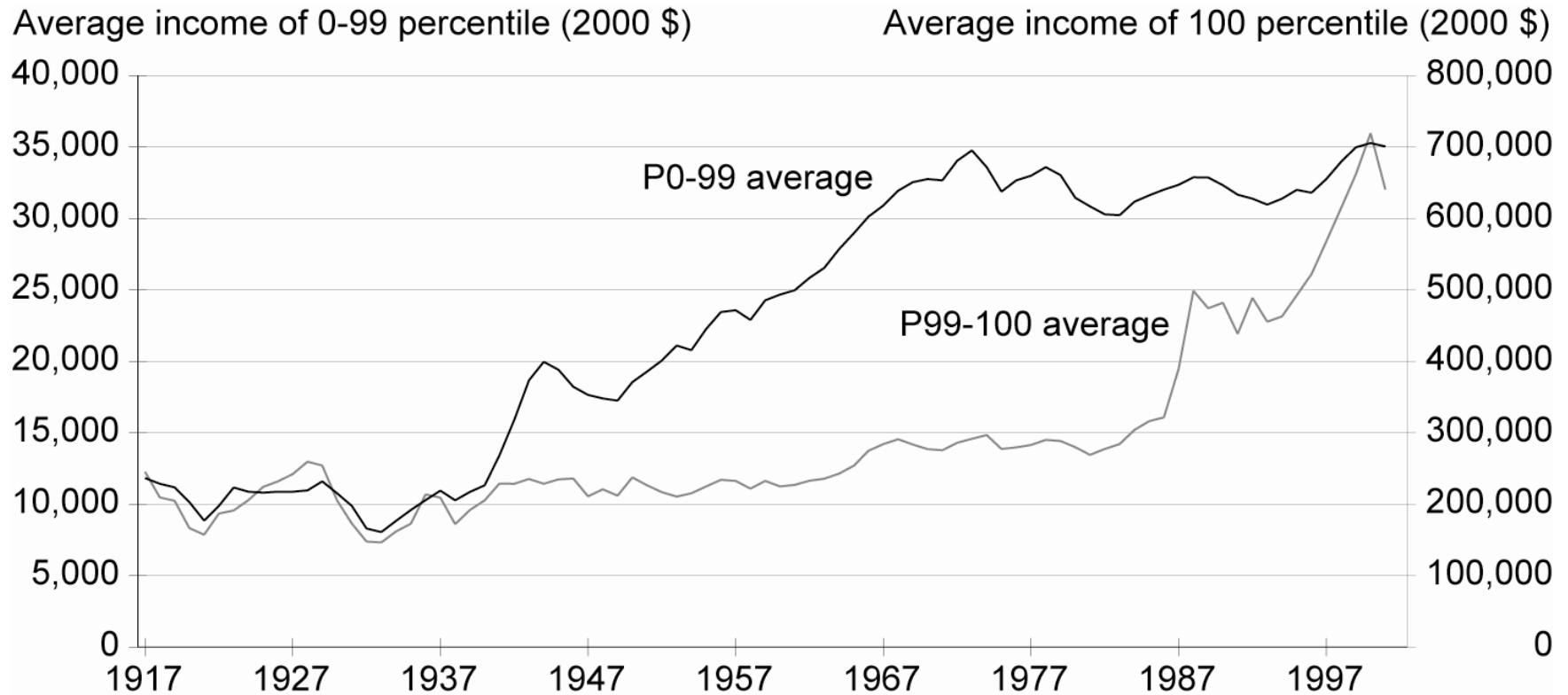
3.4 growth since collapse of dotcom bubble

- In the US, UK reduce interest rates and raise asset values An expanding housing market bubble compensated for the collapse of the stock market bubble and limited corporate investment.
- In the Euro zone stagnation prevailed: indebtedness after devaluation of US new economy acquisitions and absence of an expansionary policy

3.5 From the dotcom crisis to the financial crisis

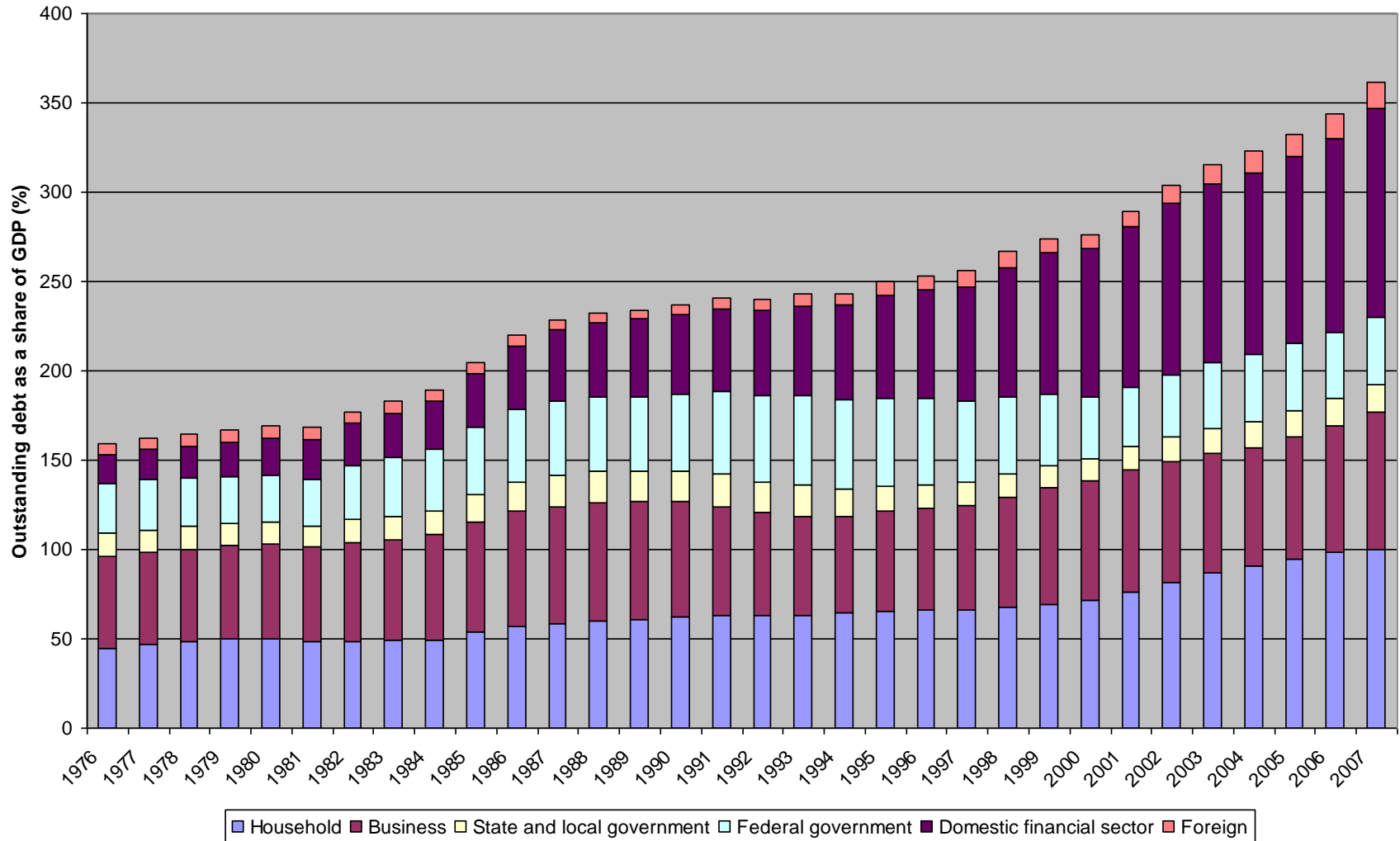
- sub-prime housing market bubble
- securitization
- leverage
- transmission from financial sector to real economy

3.6 A housing bubble and unearned wealth in an unequal society: US household income stagnates, interest rates cut, asset bubble, unearned income, savings rate declines, credit-driven consumption-led growth transfers debt

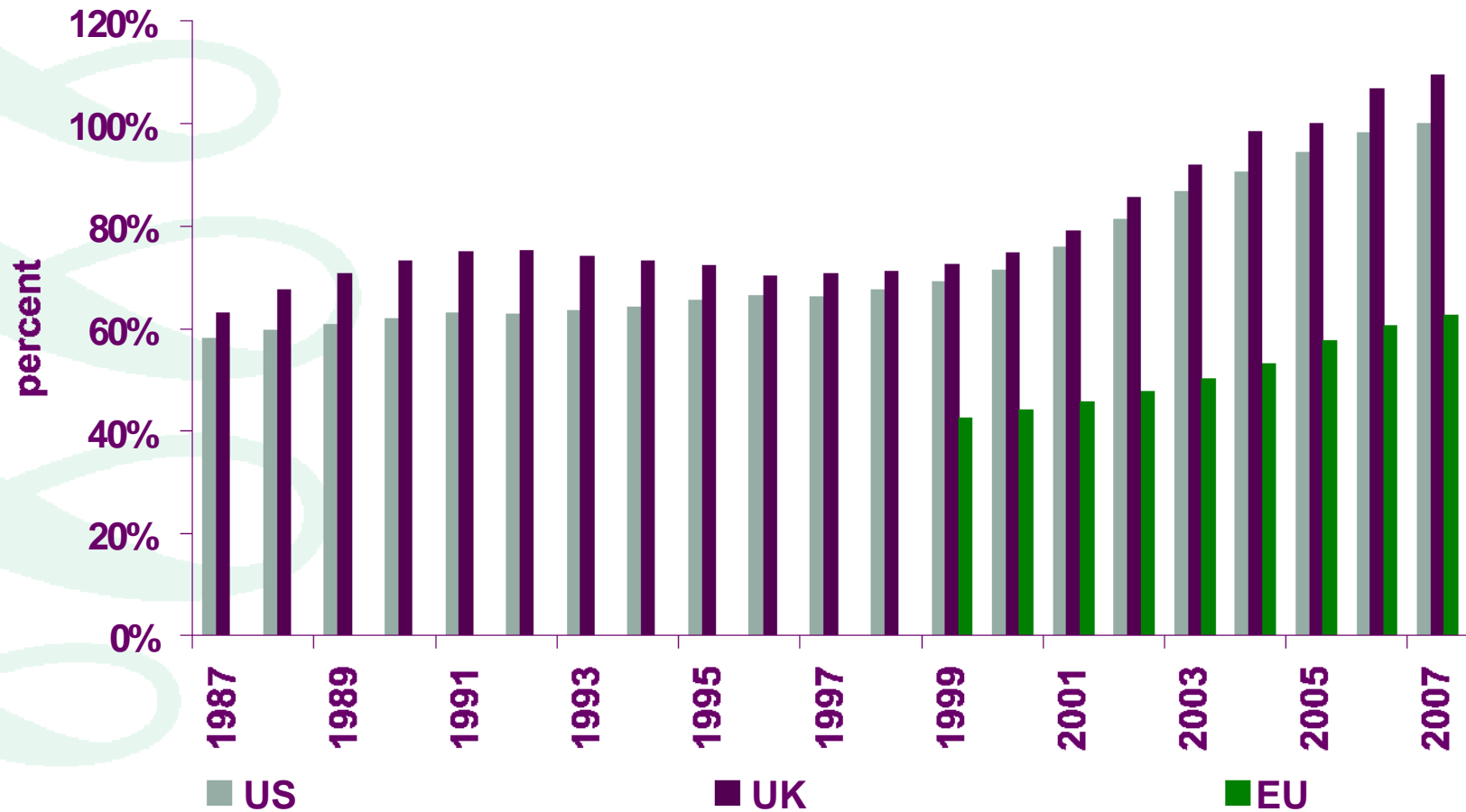


Source: Piketty and Saez

3.7 US outstanding debt

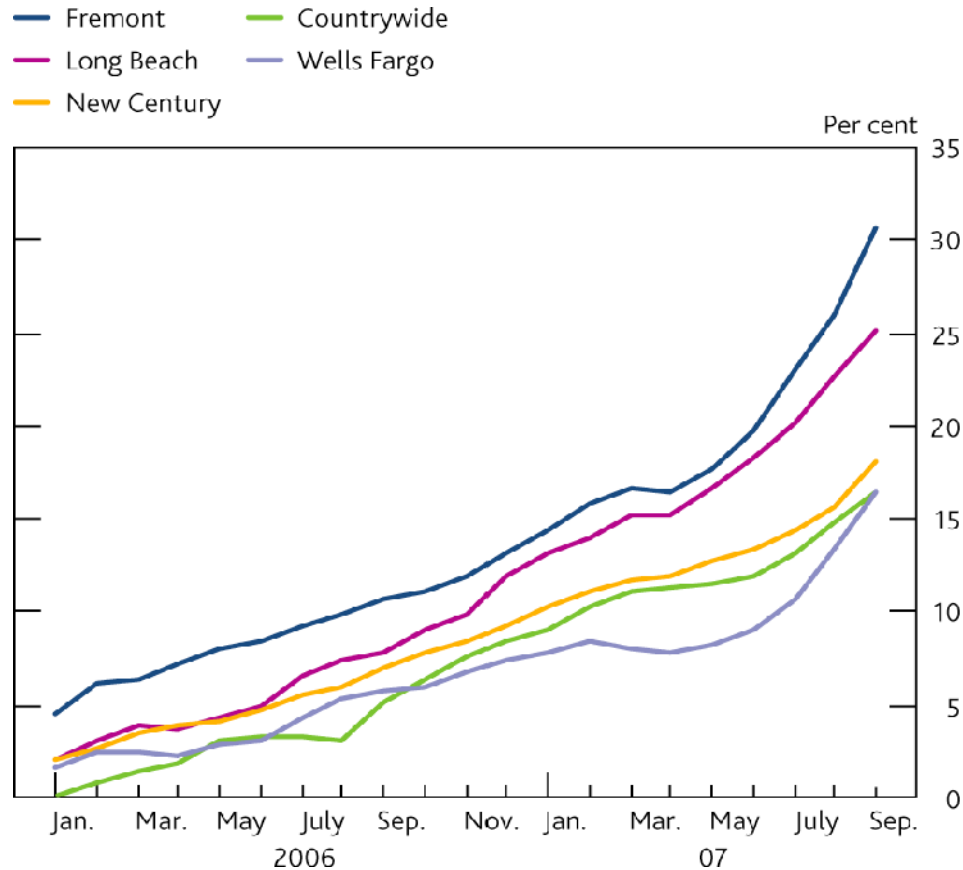


Household debt as a proportion of GDP



Source: ONS, Federal Reserve, Eurodata, Datastream

3.8 Subprime mortgage foreclosure by originator



3.9 From sub-prime to generalised credit crisis: two models of credit (Aglietta, 2008)

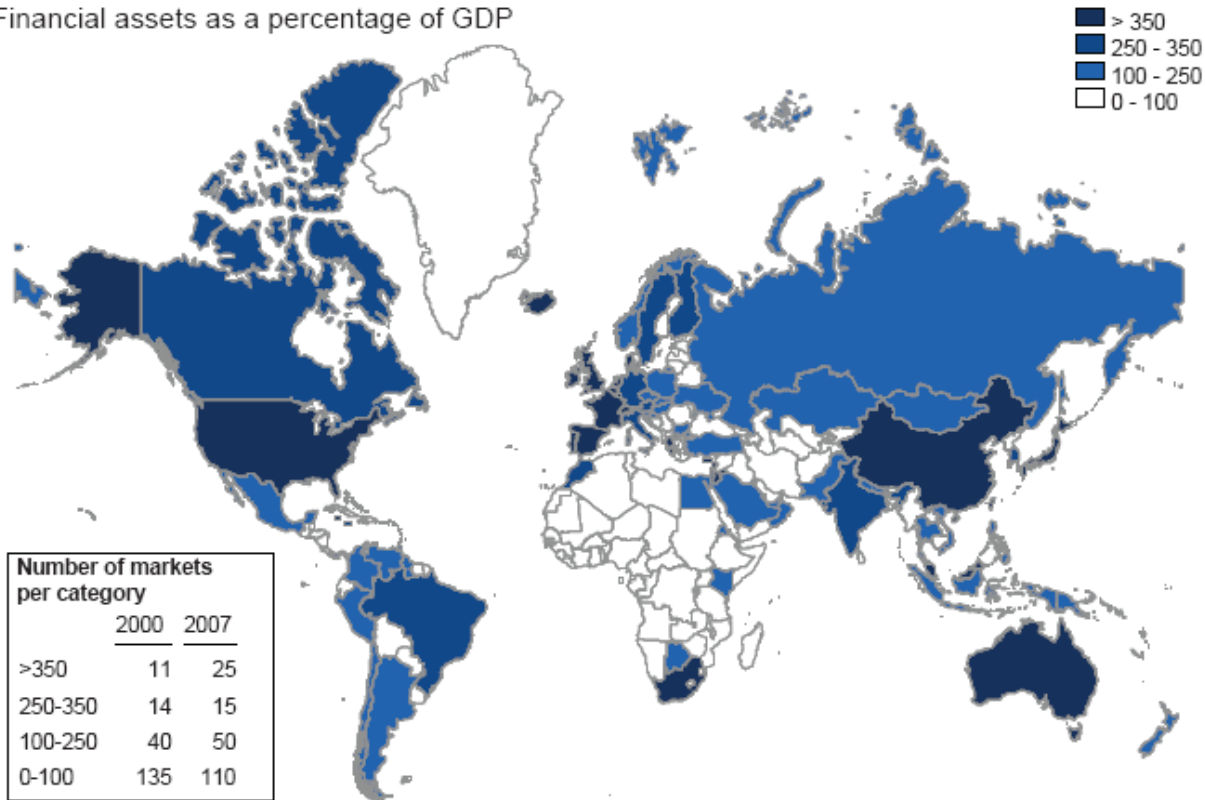
Initiate and hold	Initiate and sell risk (securitization)
Lender's profit is increasing function of risk borne	Lender's profit is an increasing function of sales of credit
Incentive to assess solvency of borrower	Incentive to sell credit against collateral
Info asymmetry contained by proximity of borrower and lender who monitors loan in execution of contract	Info asymmetry augmented by weak incentive to evaluate the risk of the borrower
Credit supplied by banks with expertise in credit risk assessment	Credit supplied by banks and unregulated private firms
Prudential control: capital provisions modulated on credit risk tails	No prudential control, no capital provision
<i>Contained moral hazard</i>	<i>Moral hazard maximised</i>

- expansion of bank's balance sheets using borrowed funds from wholesale markets rather than deposit base
- new market for securitised financial products such as RMBS, ABS, ABCP and
- move to 'originate and distribute'

Geography of financial market depth

By 2007, 25 markets had financial depth greater than 350 percent

Financial assets as a percentage of GDP

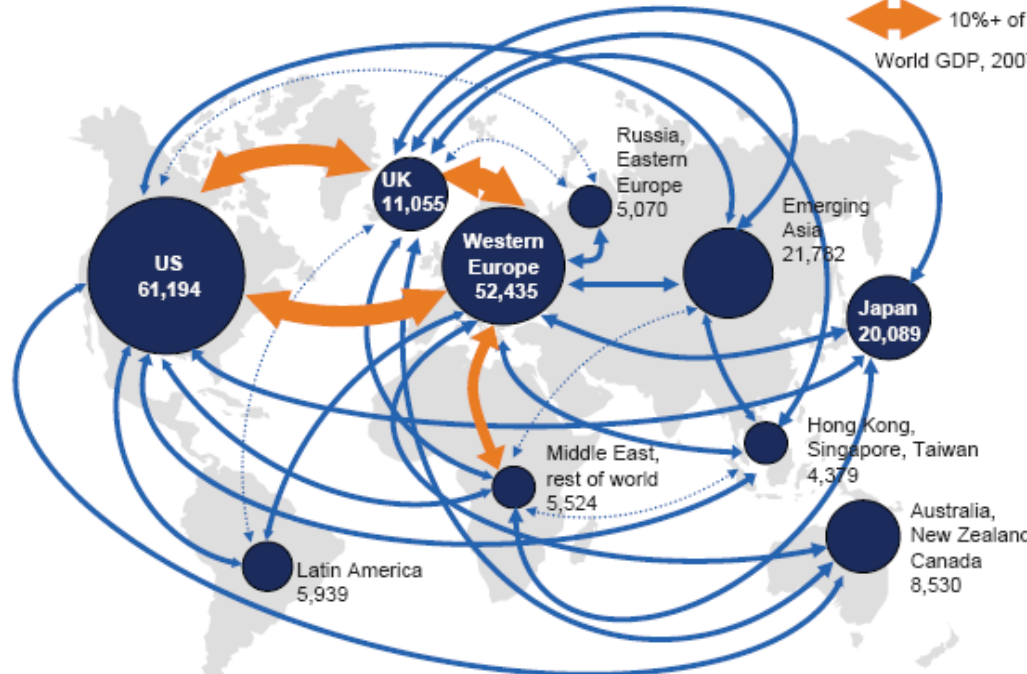


Source: McKinsey Global Institute Global Financial Assets Database

The web of cross border investments in 2007

...had grown significantly stronger by 2007

Lines show total value of cross-border investments between regions*, 2007
 Figures in bubbles show size of total domestic financial assets, \$ billion

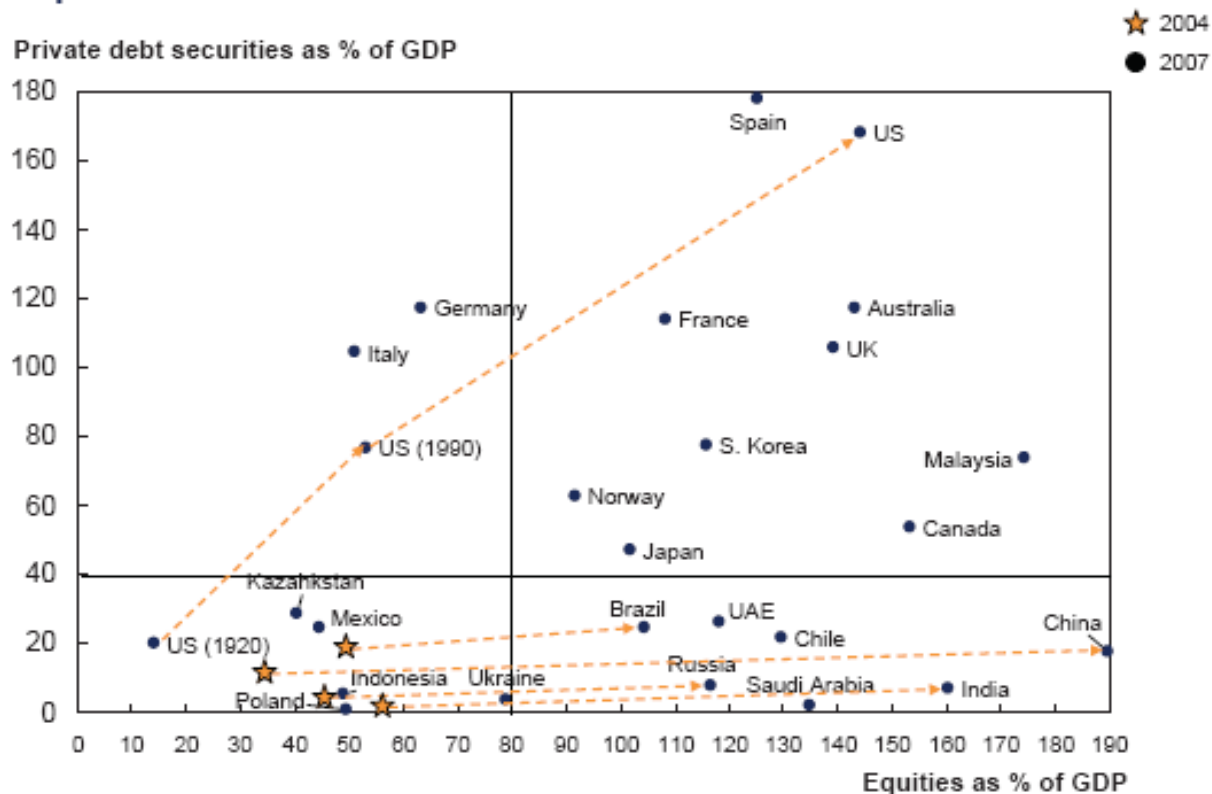


* Includes total value of cross-border investments in equity and debt securities, lending and deposits, and foreign direct investment.

Source: McKinsey Global Institute analysis

Private debt versus equities as share of GDP

Emerging market equities have grown while private debt markets remain small



Source: McKinsey Global Institute Global Financial Assets Database; Historical Statistics of the United States

3.10 ... plus the multiplier effects of leverage and weak reserve/asset requirements

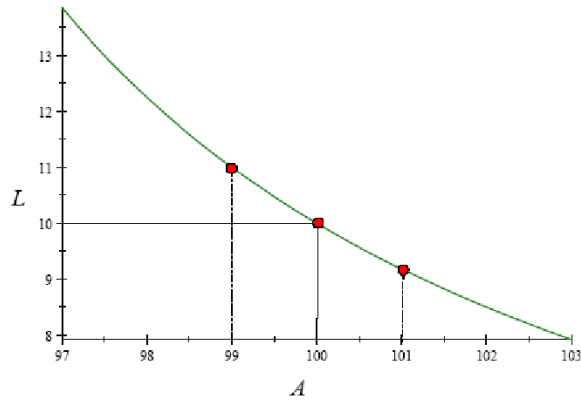


Figure 1: Leverage of Passive Investor

Assets	Liabilities
House, 100	Equity, 10 Mortgage, 90

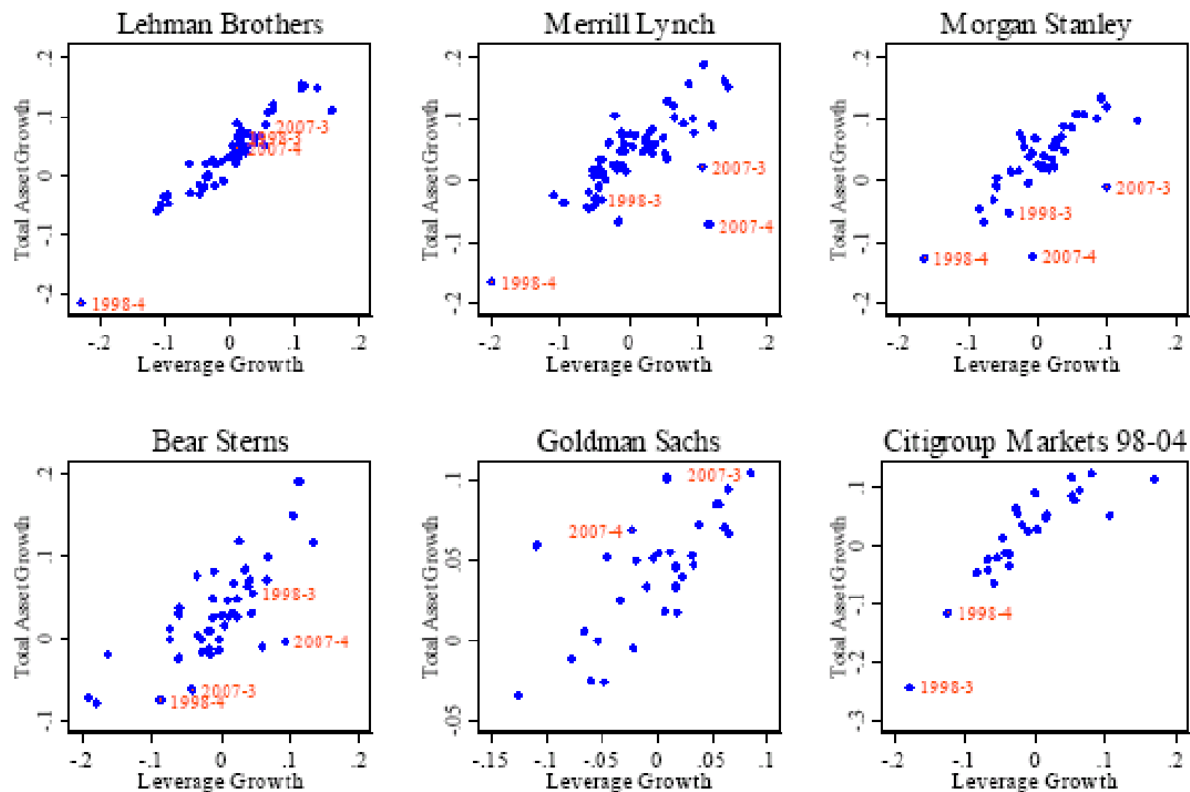
$$\text{Leverage} = \frac{\text{Assets}}{\text{Equity}} = 10$$

- A owns £100 and takes position of £2,000 by borrowing. With a modest increase in prices A makes large gains, yet if prices fall A with only £100 cannot repay

3.11 Active investors manage balance causing them to grow on both sides.

US Investment Banks

Total Assets and Leverage

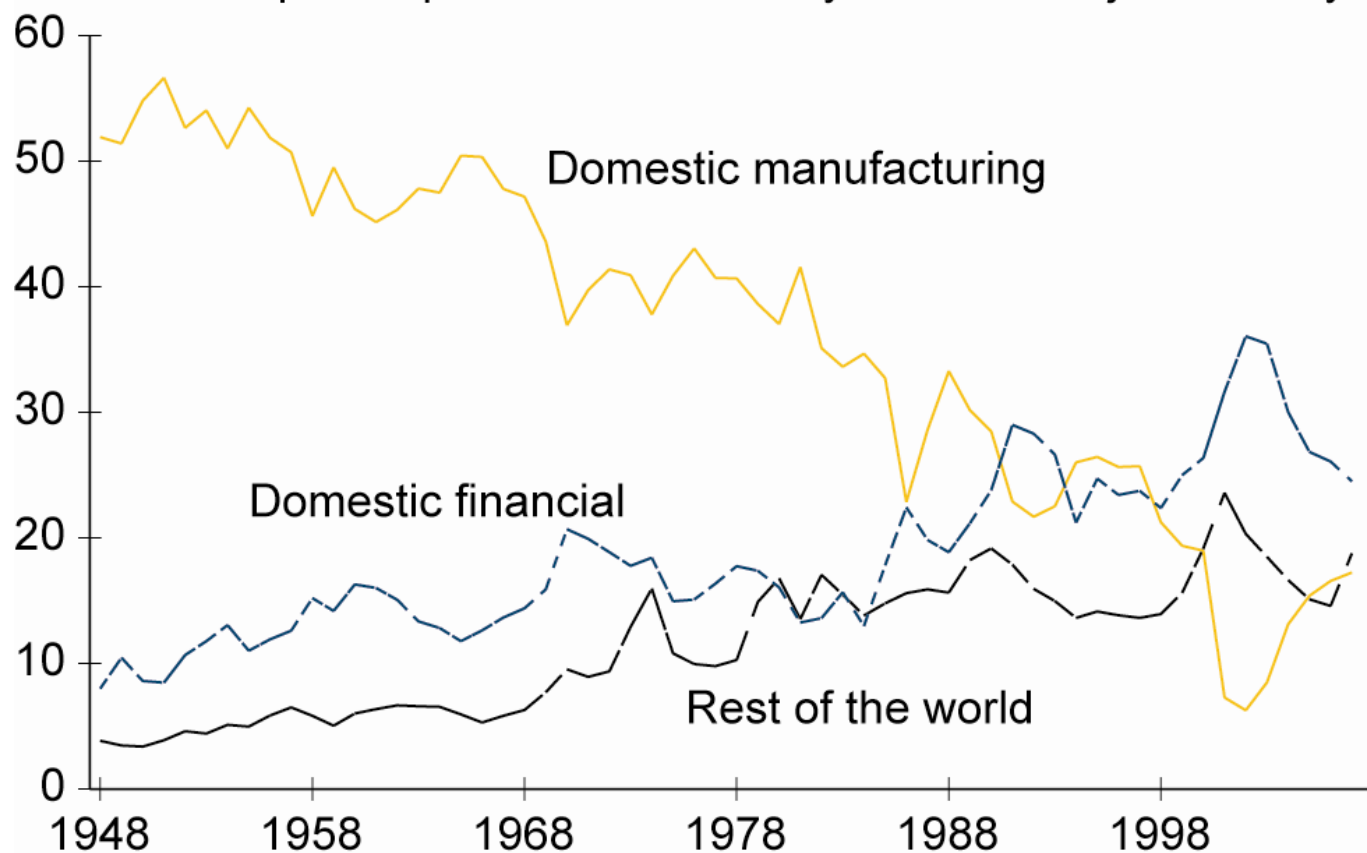


3.12 (4) Transmission

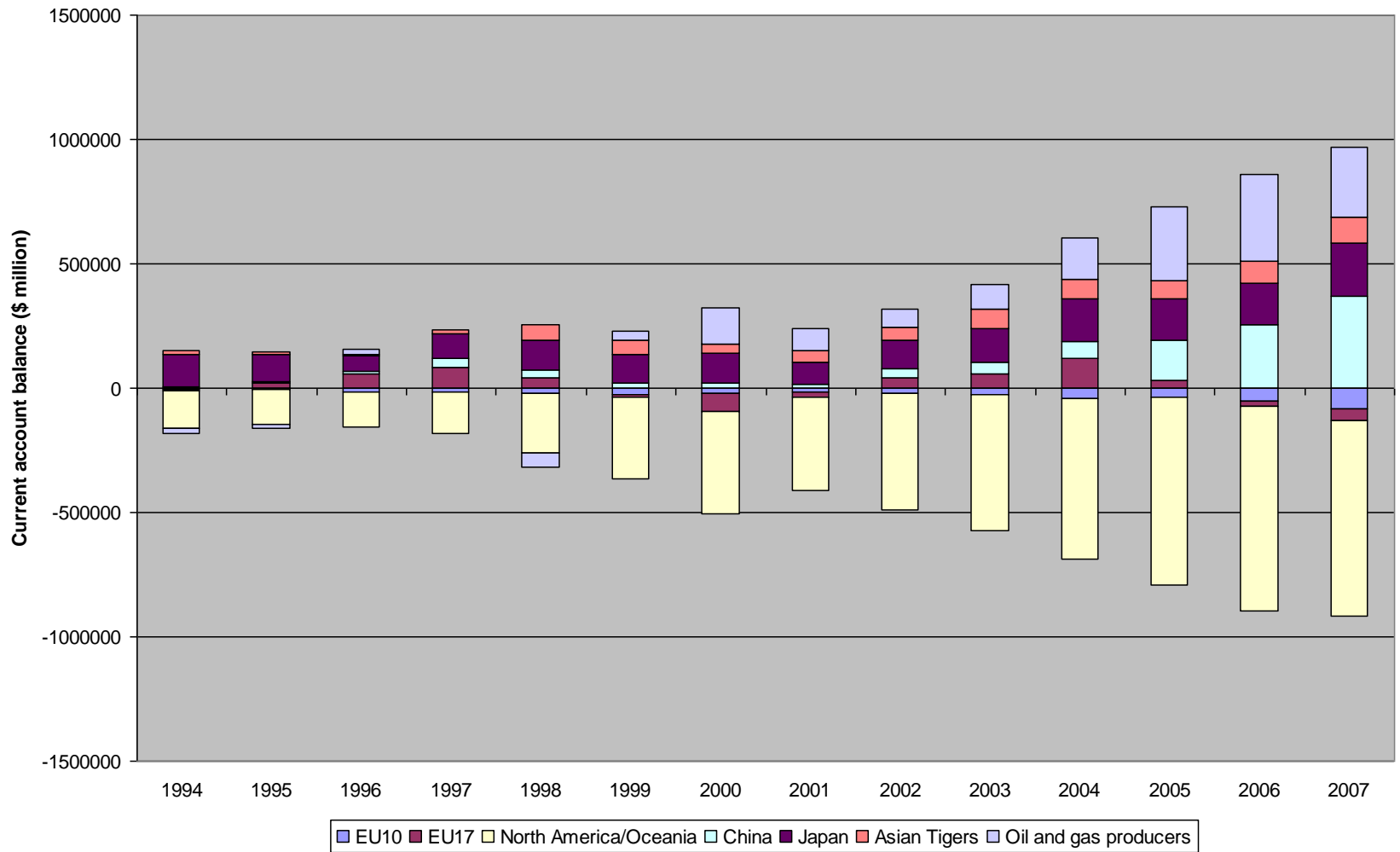
- From financial sector to the real economy
 - In financialised economies
 - In commodity producing economies
 - In export-oriented economies

3.13 US: hollowing out of manufacturing and the recomposition of US corporate profits

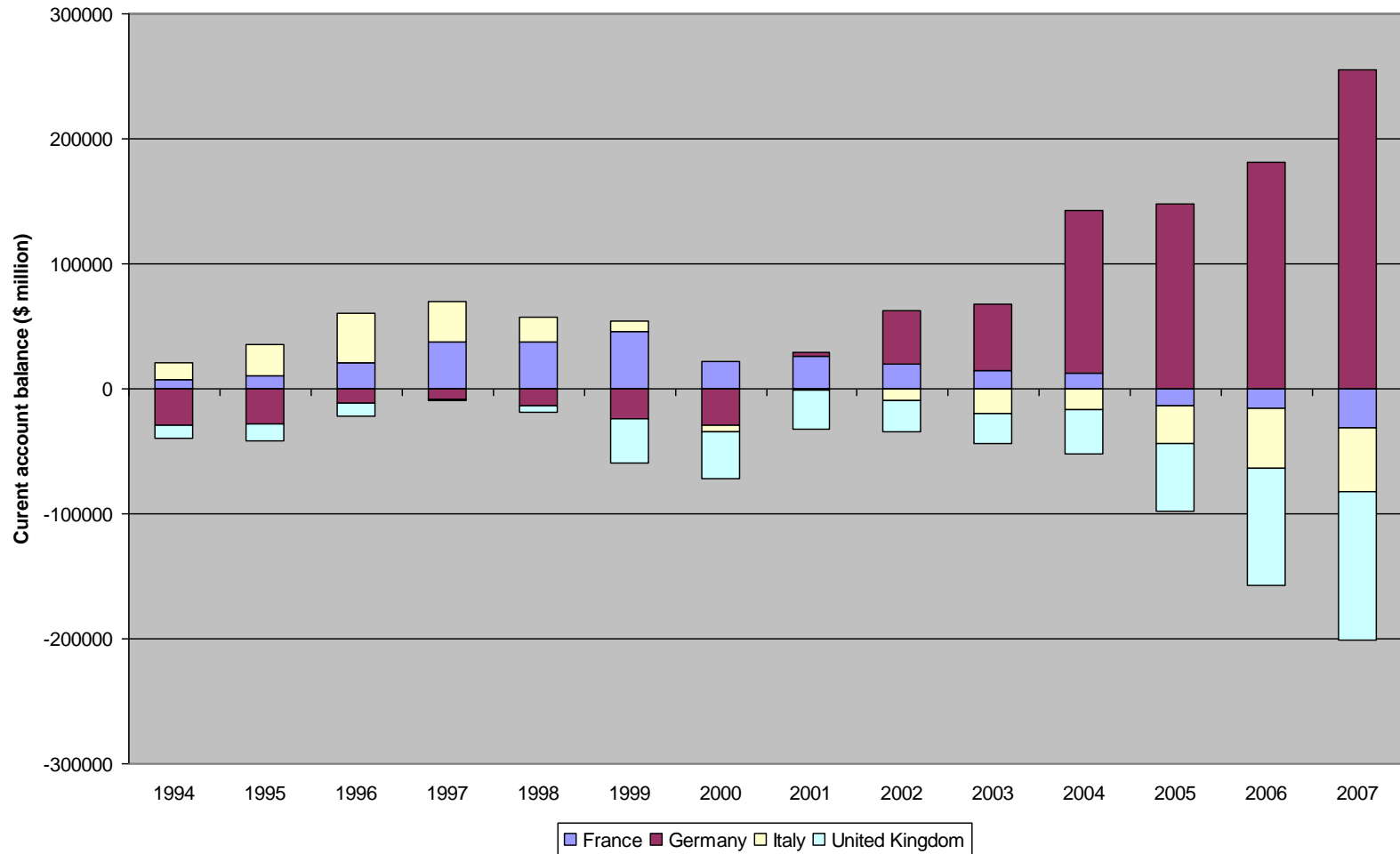
Share of corporate profits with inventory valuation adjustment by sector (%)



Global current account balances



Some EU current account balances



3.14 National and domestic: USA, China and the world

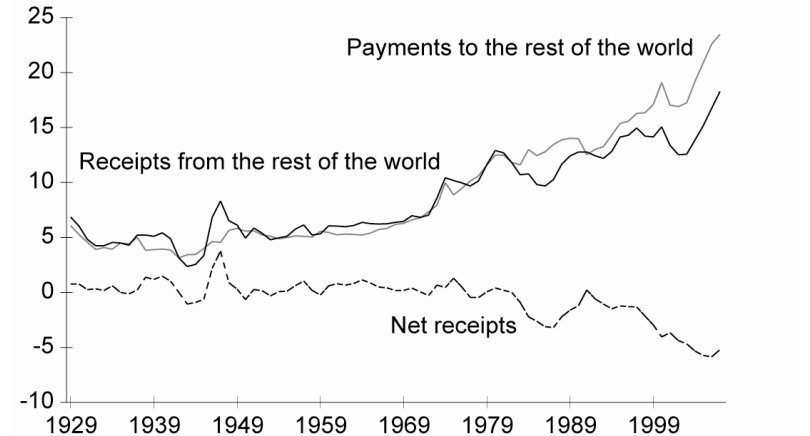
US trade/payments deficit with ROW and China

China purchases US Treasury Bonds (to protect itself against speculative attacks)

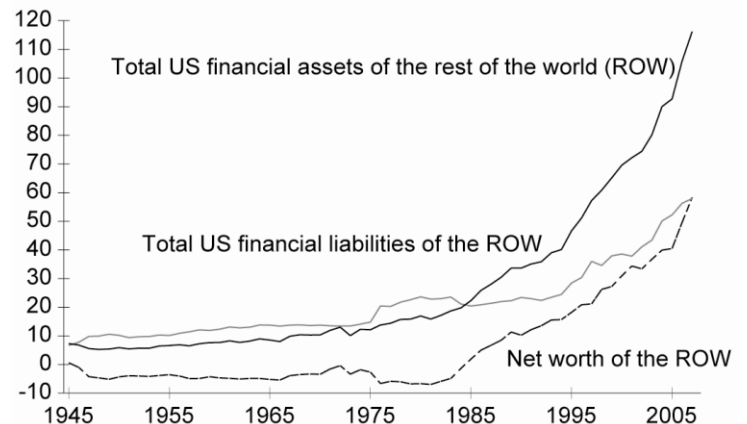
China's foreign reserves hit \$1 trillion in late 2006

China subsidises rich American consumers while China's health care, education and social safety net are starved of funds

Receipts from/payments to/net receipts from rest of the world as % of GDP



Assets/liabilities/net worth excluding tangible assets as % of GDP



3.14 An anthropogenetic development model?

- health, education and culture as direct drivers of demographic development, lives, lifestyles: production of humans by means of humans
- new core-periphery complementarities: capital transfers rather than labour mobility, technology diffusion, and accumulated wealth in Europe acquires permanent income from rest of the world due to ownership of overseas assets.

Thank you



Shareholder value

- The country has a \$14 trillion pile of household savings ... This blessing has come to be a curse to investors ... Japan's wealth shields it from pressures to meet global standards of economic growth and corporate profitability. This is what allowed the country to accept near zero growth rates in the 1990s and beyond and what allows the survival of Japanese corporate practices like valuing employees and clients over shareholders (Martin Fackler, International Herald Tribune September 2008, cited by Wade)

Three phase financial crisis

- August 2007 – February 2008, with difficulties at overstretched financial intermediaries Countrywide, Dillon Reed (US), IKB (Germany), Paribas (France), Northern Rock (UK)
- March 2008 – October 2008, following the near collapse of Bear Stearns.
- October 2008 – present, beginning with bankruptcy at Lehman Brothers