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When Will We Ever Learn?
Lessons from the global financial crisis

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The Group of 20 (G20) meeting in Toronto in June 2010 was remarkable in only one respect. The familiar protests, the

police in the streets, the hobnobbing of the leaders were all on show. But, what was extraordinary, if not unexpected, was the speed with which most of the world's most powerful leaders headed back to familiar territory – not to say, political prejudices – and not only embraced again the very nostrums that had brought about the global financial crisis in the first place, but used the crisis as an excuse to press for a smaller State and a decimated public sector, even though that threatens a renewed dip into recession.

This perverse reaction to the manifest failure of the model that had been so enthusiastically constructed over a 30 year period was a feature of not only the G20 meeting. It has characterised the responses of many individual governments around the world, and has certainly reared its head in New Zealand. Contrary to the expectations of many of us that the global financial crisis would be seen as a conclusive judgement on the failures of neo-liberal doctrine, it is the Right that seems to have emerged, for the time being at least, unscathed and emboldened by the failure of their policies. It is worth reminding ourselves of the precise lessons that the global financial crisis should, and briefly appeared to, have taught us.

1. Markets are not self-correcting.

This simple and obvious proposition, so strongly confirmed by the failure of many of the world's financial institutions, had been conveniently overlooked and even flatly denied by neo-liberal theorists. They chose to believe that operators in a market are perfectly informed and enjoy a parity of bargaining power and that market outcomes are therefore the best available and should not be second-guessed. We now know that this is self-serving nonsense, and that the natural tendency of the unregulated market is to lead to excess, irresponsibility, inefficiency and eventually collapse.

2. Financial markets are especially prone to excess.

The huge power wielded by the manipulators of international capital and the unprecedented wealth gained by operators in financial markets, resting largely on their ability to create new forms of financial assets out of nothing, led many to believe that they were the lords of the universe and could do no wrong. But, as Keynes pointed out, financial markets are the most likely to fail, depending as they do so much on hunch and guesswork and on assets whose value depends on subjective assessment and uncertain futures rather than on objective criteria.

3. Risk cannot be quantified according to reliable mathematical formulae.

A great deal of modern economics has been driven by esoteric work aimed at providing an apparently reliable basis on which risk can be quantified. It was on this basis that much of what are now recognised as having been worthless assets were happily traded from one interest to another, each trader taking a profit as the asset appeared to grow in value as it passed from hand to hand. The huge superstructure of debt and valueless assets, built initially on the sub-prime mortgage market, eventually came crashing down.

4. Decisions taken by business leaders alone are a poor guide to a successful economy and society.

Business leaders have been so eulogised over recent decades that many people were persuaded that more and more decisions affecting our lives should be handed over to them, and that they could be more trusted in many cases than our elected leaders. We now know that business decisions are invariably taken for reasons of self-interest and take little account of wider or longer-term interests. Those countries – like the US and the UK – that most enthusiastically accepted that societies should be run in the business interest are those

which have, on the whole, suffered the most severe consequences of business failures, with the greatest damage to the social fabric and environmental sustainability.

5. Increasing the wealth of the rich so that inequality widens does not produce a better economy or a stronger society.

The ‘trickle down’ theory was often used to support the proposition that, if the rich got proportionately richer, the rest of us would benefit in absolute even if not comparative terms from the lift in economic activity that the increased wealth of the rich would produce through increased investment and employment. This theory has been discredited in the absence of any credible evidence to support it, and in the face of evidence to the contrary that shows that in countries where inequality has widened the most, the living standards of the poor have actually declined.

6. Government matters.

Contrary to the constantly repeated mantra that the best thing that government can do is to ‘get off our backs’, the global crisis shows that in the end it is only governments that have the resources, will and legitimacy to underpin a failed banking system and therefore the currency and the economy more generally. Without decisive government intervention, the recession would undoubtedly have become a depression. In a recession, governments have a duty to act against market logic in a way that individuals, either people or corporations, cannot.

7. The market cannot perform effectively without government help.

The great benefits of the market can be optimised only if government, too, plays its part. The Government must do those things in economic terms, like investing in fundamental

infrastructure that the market cannot do. It must protect wider and longer-term interests that the market treats only as potential (and preferably 'externalisable') costs – interests such as those of people who are left behind by the market, or the value of a whole, healthy and integrated society, or the importance of maintaining scarce resources and a clean and sustainable environment. It must correct mistakes made by the market and regulate the market to avoid excess and failure.

8. If the market cannot be challenged, the whole point of democracy is lost.

The most significant aspect of the global economy that has developed over the past three decades has been the extent to which governments have been sidelined by the power of international investors to move capital around the world, and to hold governments to ransom by withholding investment if their requirements are not meant. The role of democratic government is, after all, to bring the power and legitimacy of the people's will to bear so as to offset what would otherwise be the overwhelming economic power of capital. If the market is held to be infallible, and government must not intervene, we not only produce bad economic and social outcomes; we lose the point and effectiveness of democracy itself.

None of these conclusions is revolutionary or even particularly radical. Each is evidence-based and arrived at through the merest common sense based on our own recent experience. This makes it all the more remarkable that these lessons are increasingly discounted by world leaders as they move into what we might all have hoped would be a post-crisis environment.

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