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Global credit squeeze: Crippled capitalism or Bail-out statism? [1]

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I. Introduction

As the global credit squeeze continue to victimize more people – capitalists and workers, entrepreneurs and self-employed – some groups on the left have been proudly warning that "capitalism is nearing its end" and the time for heavy State regulations, high taxation and bail-out statism, the time of "soft socialism", is coming.

Below is one of several cartoons and pictures that articulate the sentiment or belief of the coming "death" of capitalism.

Source: http://www.economist.com/opinion/displayStory.cfm?Story_ID=12429544

The background was that various governments around the world were planning, if not announcing or actually dispensing, billions of dollars of taxpayers' money to bail-out

[1] Presented at "Forum on Tax Regulations on Cooperatives and Awareness on Global Financial Crisis", sponsored by Tagalog Cooperative Development Center (TAGCODEC), GEMS Hotel and Conference Center, Antipolo City, Rizal, December 10, 2008
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(aka "rescue", "financial relief") struggling giant corporations that were deemed "too big to fail". Along with these bail-out plans and programs are several pages more of proposed new and additional government regulations to "stop" similar crisis to happen in the future. Also plans to set up new international or multilateral bodies, or "strengthen" existing multilateral bodies, to monitor financial transactions around the world and "blow the horn" as soon as potential crisis situation is forming, before they explode. Thus, more government role and intervention in business, and they called this "capitalism at bay". Or to simplify,

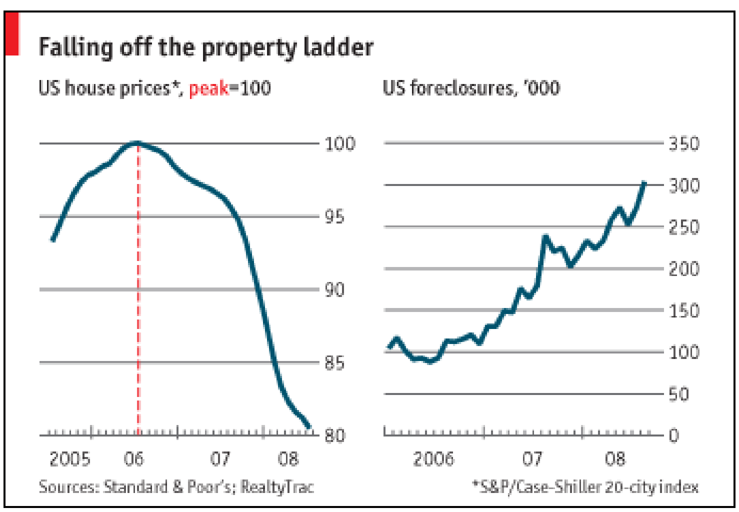
Bail-outs + new regulations + new international bodies = "Capitalism at bay."

Capitalism at bay, true. And it's true not only in the current global financial turmoil, but even before that, several years and decades ago of multiple government regulations and implicit control of a big section of many countries' economy.

II. Global credit squeeze, why?

The term "credit squeeze" is more acceptable and more appropriate for this author than "credit crisis" or "financial crisis". What the world, the rich countries in particular, are experiencing is not yet a "crisis" situation where they are on the verge of collapse like what happened to Iceland, or moving towards recovery. Rather, the world is undergoing market self-correction, from asset bubbles to asset price revaluation; from wild speculation of upward price movement to sober realization that the law of gravity applies not only in physical objects but also in financial wealth.

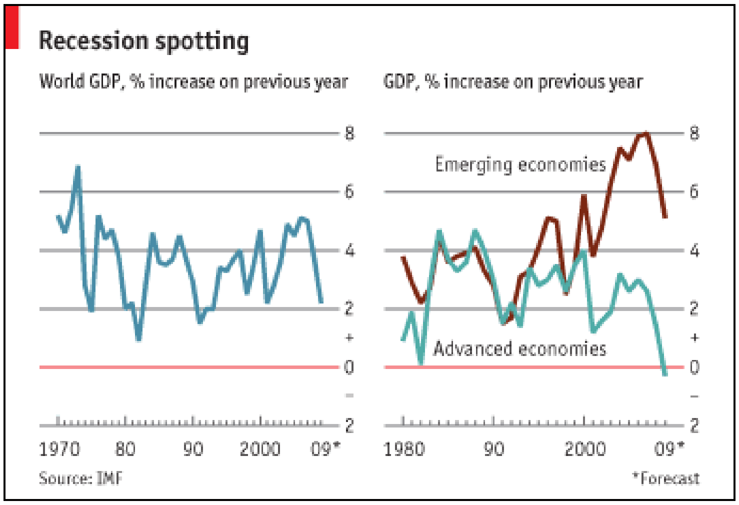
The credit squeeze and turmoil began when plenty of sub-prime loans experienced payment default by a substantial number in middle of 2007. Those loans were potentially catastrophic because of the huge amounts involve, up to several trillion dollars total, and the "information asymmetry" that went with it.



Source:
http://www.economist.com/finance/economicsfocus/displaystory.cfm?story_id=12470547

Chart above shows steep decline in US house prices beginning in early 2007, measured by an index. Consequently, the volume of home foreclosures have also increased drastically in that period.

Global output is still not in any recessionary trend. There is still economic growth in many parts of the world, the emerging markets especially, although such growth will not be as high as the past few years. Those that experience recessionary trend are the rich economies in the world – US, Japan, Germany, other EU countries.



Source:
http://www.economist.com/finance/economicsfocus/displaystory.cfm?story_id=12553076

Above chart shows global GDP on a roller-coaster ride of up and down over the last 3 decades. The worst years were the 1982 and 1991, with growth of 0.9% and 1.5% respectively.

Trailing the turmoil "generators", below are some of the more important causes.

1. US government intervention in housing credit

Past US government policy has somehow forced banks to give out bad loans, and more bad loans indeed were given away. Eamonn Buttler in his article, "*Blame bad rules, not capitalism*", wrote "(On) 12 October 1977, US President Jimmy Carter signed the 'anti-redlining' law. Before then, lenders generally denied loans to people in poor neighborhoods. But the politicians – with good intent – wanted to make home ownership available to all Americans. So lenders were forced into giving out risky mortgages: what we now call 'sub-prime' loans."

David Littman in his article "*The government's plan to fix Wall Street will do more harm*", also cited the "anti-redlining" law, Community Reinvestment Act (CRA, 1977 during the Carter Administration). He said that the law "compelled banks and other lenders to loan money and grant mortgages in areas where they'd have never dreamed of making such loans, due to exceptional risks of default. Banks were denied charters for growth and geographical expansion if found by regulators to be out of compliance with these politically-correct regulations."

Then there were Government enterprises Fannie Mae and Freddie Mac that receive taxpayer with the implicit and lately explicit, function to guarantee risky mortgages. These were major State interventions that helped produce major abuses and corruption of personal and corporate discipline. Making a bad public policy even bigger. Freddie and Fannie state enterprises made investors believe that the bad mortgages they made were guaranteed by government, creating a "moral hazards" problem wherein complacency can be rewarded with bailout, not penalized with bankruptcy.

To say that today is a "crisis of free market and deregulated capitalism" is not exactly correct, Anywhere one will go, or whatever one will do, almost always, there are government regulations.

Johan Norberg, author of the book "In defence of global capitalism", argued in his article, "*Regulators cannot avert next crisis*" that "Every crisis has led to thousands of inew pages of regulation. Why is it that regulation doesn't stop crises from happening again? Look no further than the US federal institutions in Washington, DC, and we find 12,113 individuals working full time to regulate the financial markets. What did they do with the powers they had? So we get new rules that target the mistakes that everybody already knows they must avoid. The next possible crisis and its causes are so far unknown, and our regulations may have no effect or even make them worse..."

2. Debt culture, Governments

The US government, well all governments of G7 member-countries, is among the most indebted countries in the world. Being trapped in budget deficit (expenditures larger than revenues) annually is the norm for them. Below are some figures.

Table 1. General Government Gross Debt, % of GDP

G7 Countries	1980	2007
Japan	52.1	195.4
Italy	56.9	104.0
Canada	45.6	64.2
France	20.4	63.9
Germany	31.3	63.2
United States	**43.6**	**60.7**
United Kingdom	46.1	44.1

Source: IMF, World Economic Outlook, October 2008, Database, http://www.imf.org/external/pubs/ft/weo/2008/02/weodata/

Current debt and future, unfunded welfare programs will be very huge. One estimate puts the Federal government is facing an estimated $56 trillion debt. In a commentary, "*America's $53 trillion debt problem*," David Walker wrote: "The nation's real tab amounted to $53 trillion as of the end of the last fiscal year (September 30, 2007). That was the sum of our public debt; accrued civilian and military retirement benefits; unfunded, promised Social Security and Medicare benefits; and other financial obligations… The rescue package and other bailout efforts for Fannie Mae, Freddie Mac, AIG and the auto industry, escalating operating deficits, compounding interest and other factors are likely to boost the tab to $56 trillion or more by the end of this calendar year."

The US' gross domestic output (GDP) last year was $13.8 trillion. The cumulative debt of the federal government alone will be about 4x of GDP! GDP is the combined production of goods and services by the federal, local and state governments, private corporations and households. So, can an institution that can irresponsibly accumulate various debts amounting to 4x of GDP, be expected to provide leadership in disciplining all corporations, earning or misbehaving, private corporations? This does not look good.

Below is another indicator "debt culture" of the US economy.

Table 2. Major net exporters and importers of capital*, 2007:

Net exporters	**% share**	**Net importers**	**% share**
1. China	21.3	1. US	49.2
2. Germany	14.5	2. Spain	9.8
3. Japan	12.1	3. UK	8.0
4. Saudi Arabia	5.5	4. Australia	3.8
5. Russia	4.4	5. Italy	3.5
6. Switzerland	4.1	6. Greece	3.0
7. Norway	3.4	7. Turkey	2.5
8. Netherlands	3.0	Other countries	20.2
9. Kuwait	2.8		
10. Singapore	2.2		
Others			

* Measured as countries' capital account surplus and deficit, respectively.

Source: IMF, Global Financial Stability Report, October 2008
http://www.imf.org/external/pubs/ft/gfsr/2008/02/pdf/statappx.pdf

3. Debt culture, Households and Corporations

While governments are the most typical practitioners of financial irresponsibility, of living beyond one's means and going to chronic debt to pursue any vaunted social goals, households and corporations also have their share of high debt culture.

Below are some indicators showing this.

Table 3. Selected financial indicators, household and corporate sectors

Indicators	2002	2004	2006	2007
A. Households, Net worth/disposable personal income				
1. USA	498.8	553.6	578.2	556.2
2. Japan	725.2	723.0	744.1	…
B. Corporate sector, Interest burden*				
1. USA	14.4	8.6	6.3	6.4
2. Japan	27.8	18.4	15.2	16.2
3. Europe	18.4	17.4	19.8	…

* Interest burden = net interest payment / pre-tax income (US)
= interest payment / operating profits (Japan and Europe)

Source: IMF, Global Financial Stability Report, October 2008
http://www.imf.org/external/pubs/ft/gfsr/2008/02/pdf/statappx.pdf

US and Japan's households have high networth as percentage of their disposable personal income, more than 500 percent and more than 700 percent, respectively. One way of interpreting this is that households and individuals in those two countries have very high assets and networth relative to their after-tax personal incomes. And those assets would include expensive houses and their elegant interior designs, furnitures and appliances, and so on.

III. Some implications for the Philippines

The Philippines being relatively well-integrated to the world economy, will definitely feel the pinch of the current economic turmoil. By how much and what sectors?

There are various transition mechanisms by which the credit tightening will reach its final destination: more unemployment, more poverty. Three macro indicators will be briefly analyzed: (a) foreign investments into the Philippines, (b) remittances by overseas Filipino workers (OFWs), and (c) Philippine merchandise exports.

Tables below will show some avenues by which income and investments in the Philippines can be affected.

*Table 4. Net Foreign Direct Investments * in the Philippines, $ Million*

Rank in 2008	2000	2007	Jan-Aug 2008
Total Net Equity	**1,333.0**	**2,020.0**	**789.00**
1. United States	155.43	664.65	216.00
2. Singapore	48.55	-5.39	145.86
3. Japan	107.35	827.07	107.38
4. S. Korea	0	14.46	28.08
5. Germany	0.36	16.03	17.65
6. Malaysia	15.16	5.96	14.83
7. Hong Kong	45.34	3.29	8.31
8. Taiwan	3.36	0.09	6.52
Others			

* Net FDI is computed as: Non-residents' (placements – withdrawals) + reinvested earnings + net intercompany loans

Source: Bangko Sentral ng Pilipinas, www.bsp.gov.ph/statistics/spei/

The first eight months of the year already showed drastic decline in net foreign equity investments in the country. If current trends will continue, it is possible that full year FDI will only be one-half of 2007 level. Investors from the US, Japan and the European Union, except from Germany, showed huge decline in their investments this year. If not for the investors from Singapore, S. Korea and Malaysia, FDI levels would have been worse.

Decline in portfolio investments such as the stock market simply mirror the trend in the world's biggest stock markets like Dow Jones, FTSE and Nikkei.

Income declines in rich countries are always suspected to negatively affect their hiring of foreign workers, and consequently, foreign exchange remittances by foreign workers, including millions of overseas Filipino workers (OFWs). If the current credit tightening and lack of confidence in the global investment climate will continue for long, it is possible that many of those will be packing back home as the employment situation in their host countries will deteriorate.

Luckily though, remittances for the first nine months of the year did not look bad. From an average of $1.2 billion per month in 2007, this year it is $1.36 billion per month on average. The bulk of such remittances come from North America, the Middle East, and Europe. In particular, remittances from Canada can possibly reach a billion dollars, a big jump from previous years' levels. See table below.

Table 5. OFW Remittances, in $ Million

Rank in 2008	2000	2007	Jan-Sept. 2008
Total Remittances	**6,050**	**14,450**	**12,273**
1. United States	3,945	7,565	5,938
2. Saudi Arabia	494	1,141	1,051
3. Canada	47	595	884
4. United Kingdom	91	684	601
5. Italy	161	636	539
6. United Arab Emirates	28	530	474
7. Singapore	105	386	375
8. Japan	370	402	375
9. Hong Kong	147	383	311
10. Germany	101	208	227
11. Norway	14	159	149
12. Bahrain	13	142	126
13. Taiwan	142	183	128
14. Kuwait.	36	165	97
15. Qatar	1	132	92
16. Australia	16	92	95
17. Greece	54	99	86
18. S. Korea	42	95	63
19. Spain	4	86	62
20. Malaysia	9	59	61
Others			

Source: Bangko Sentral ng Pilipinas, www.bsp.gov.ph/statistics/spei/

Merchandise exports, along with exports of services, are among the most vulnerable in periods of economic slow down if not recession, among the world's richest countries. Luckily for the Philippines, it has diversified its exports market, away from the US and towards its neighbors in Asia.

Until ten years ago, slightly more than one-third of Philippine exports went to the US (mainland plus territories like Guam, Saipan, and non-mainland states Hawaii and Alaska). With rising regionalism in world trade, a growing number of Philippine exports are now going to China, Hong Kong, Korea and Singapore.

Table 6. Philippine Exports by Country Destination, in $ Billion except %

Rank in 2008	1998		2007	Jan-Sept. 2008	
1. United States	10.10	**34.2%**	8.59	6.33	**16.3 %**
2. Japan	4.23	14.3%	7.29	6.03	15.5%
3. China			5.72	4.47	**11.5%**
4. Hong Kong	1.32	4.5%	5.80	3.88	**10.0%**
5. Netherlands	2.32	7.9%	4.15	2.93	7.5%
6. Singapore	1.83	6.2%	3.13	2.20	5.7%
7. S. Korea			1.78	2.09	**5.4%**
8. Germany	1.03	3.5%	2.14	1.90	4.9%
9. Malaysia	1.14	3.9%	0.64	1.60	4.1%
10. Taiwan	1.76	6.0%		1.47	3.8%
Others					
TOTAL	**29.9**	**100 %**	**50.28**	**38.87**	**100 %**

Source: National Statistics Office, www.census.gov.ph

From $4.2 billion per month last year, so far the Philippines has been exporting $4.3 billion per month on average.

If China, Hong Kong, Singapore and S. Korea can spare their economies from deep recession that the US and Japan currently experience, Philippine exports can expect to retail its modest growth in exports.

IV. Lessons for the Cooperative Sector

Save. Save during "normal" times to help you manage during difficult times. It is impossible for humans to perfectly see the future. Opportunities abound, yes, especially if one is very hard-working, efficient and ambitious. But so risks and crisis abound.

Don't live beyond your means, assume more personal, corporate, and cooperative responsibility. If you have low or unstable income, don't buy an expensive house. And if you're a bank, don't lend someone a high value product (house, car, etc) if you perfectly know that his/her capacity to pay is suspect. And if you're a government, don't engage in spending splurge through endless and mindless borrowings.

There are 2 important characteristics of government that people should always remember. One, government has no money on its own except what it takes from the people (taxes, fees, charges, fines). Two, government is force. So, if more government support and subsidy is sought, prepare for additional regulations and taxation.

Be transparent. Always, or at least, most of the time.

VI. Concluding Notes

Crippled global capitalism because of endless government taxation, regulation and other forms of intervention, is limping today but never down or falling. That is because capitalism is a very subversive social system – subversive and dangerous to the complacent, monopolists and irresponsible, those who do not want constant change. Thus, under capitalism, corporate success and failure is as sure as the sun rising and setting down everyday. Capitalism without failure is like religion without sin. Or like Christianity without hell.

The various government tools and policies purportedly meant to "discipline" capitalism so that it will not abuse its subversive power and will not experience large-scale corporate bankruptcies, more often than not, are the same tools that cause complacency and irresponsibility, usually among the favored and State-guaranteed capitalists. Julian Morris of International Policy Network (IPN) and Bill Stacey of Lion Rock Institute (LRI) are correct when they noted that

"We caution against any direct intervention by government. Governments are terrible at allocating resources and their attempts to boost our economies will almost certainly backfire. Economic growth is the result of entrepreneurs identifying and filling niches by developing better products and production processes, thereby boosting production and productivity. In contrast, when governments throw money at the economy, they divert resources away from their most efficient and effective uses, undermining innovation and growth. The best way to stimulate the economies of the world would be to reduce the number of overbearing taxes and regulations that currently inhibit the development and delivery of all manner of products and services." (Morris and Stacey, 2008)

Bail-out statism and soft socialism have been tried in many countries at many period in time. The current credit squeeze is one of their long-term and continuing negative consequences. The multiple taxes, fees and regulations associated with bail-out statism and welfarism are not only inflationary (they make the taxed and regulated products and services more expensive than if those mandatory payment to the government were absent), they also dampen if not kill entrepreneurship and competition in many sectors and sub-sectors of the economy.

Annex Table:

Gross Domestic Product based on Purchasing Power Parity (PPP) valuation of country GDP, in $ Billion

Rank 2007	Economy	1980	2007	Multiple increase
1	United States	2.789.5	13,807.6	4.9
2	**China**	**249.1**	**7,034.8**	**28.2**
3	**Japan**	**1,039.4**	**4,292.2**	**4.1**
4	**India**	**271.2**	**2,996.6**	**11.0**
5	Germany	752.6	2,812.3	3.7
6	United Kingdom	486.6	2,167.8	4.5
7	Russia	n/a	2,089.6	
8	France	536.7	2,067.7	3.9
9	Brazil	444.0	1,837.1	4.1
10	Italy	507.6	1,787.9	3.5
11	Mexico	333.1	1,486.3	4.5
12	Spain	272.5	1,351.5	5.0
13	Canada	272.1	1,269.7	4.7
14	**Korea**	**94.8**	**1,201.9**	**12.7**
15	Turkey	116.3	885.9	7.6
16	**Indonesia**	**107.7**	**838.5**	**7.8**
19	**Taiwan**	**60.0**	**696.1**	**11.6**
24	**Thailand**	**50.7**	**519.8**	**10.3**
26	**Pakistan**	**49.1**	**410.3**	**8.4**
30	**Malaysia**	**32.4**	**359.3**	**11.1**
37	**Philippines**	**60.3**	**299.7**	**5.0**
38	**Hong Kong**	**36.9**	**293.3**	**7.9**
45	**Singapore**	**16.8**	**228.3**	**13.6**
47	**Vietnam**	**16.2**	**221.6**	**13.7**

Source: IMF, World Economic Report, October 2008, Database; http://www.imf.org/external/pubs/ft/weo/2008/02/weodata/

PPP valuation is used by economists to account for relative prices of similar goods and services across countries.

The above figures show that three of the five biggest economies in the world as of 2007 were Asians – China, Japan and India. In 1980, the combined size of their economies were almost one-half that of the United States. After 27 years, their combined size of economy is larger than that of the US at more than $14 trillion.

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