

# How west went bust

Economics



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The Global Financial Crisis of 2008 is the most serious Financial Crisis after the Great Depression of the 1930's. Years of Borrowings from Banks, Governments, Households & Companies have led many of people in WEST hopelessly into DEBT. What the west have done is they have funded Unsustainable lifestyle using others money i. e. Debt. Debt was thought as developing Countries' problem, but it has now become Developed Countries' Problem. The financial sector was saying the prices of the Houses are never going to fall at least since the Great Depression but actually now they have fallen. Shanghai — China's Commercial Capital. China & other Developing Economies produce what the Richer Economies need. For example of the inequalities in the world wide Economies, a person doing a same job for a same company got lesser salary in the developing economies like China compared to that in Developed Economies like UK (may be China not any more a developing Economy as it the 2nd largest Economy after US). For example a Marketing Manager for NVC Lighting gets around mid 40-50k pounds a year whereas a Marketing Manager in the same company in china gets around 15-20k pounds a year. We also need to keep in mind the fact that this manager in china worked all day & even some nights to get that salary. The same inequality exists in the shop floor also. A shop floor worker in china works for around 30-40 hours a month to get 250 pounds a month. Whereas a shop floor worker in the same NVC Lighting company works for 42 hours a week to get 1000 pounds after tax and all without overtime. In today's world Economy, the developing economies were making goods for cheap rates which satisfied the needs of Developed Economies, everybody seems to be a winner except the economic system we developed contained lethal flaw. The flaw is — the developed economies bought cast quantities of

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consumer goods for cheaper rates from developing economies like china WITH BORROWED MONEY. These people haven't worked hard enough or smart enough to compete with economies like China & other developing economies. Households borrowed too much, Banks that have lent to us have also found to be too much of debt & not to forget the likes of Government which have borrowed much more than they can afford. Now the people have started to recognize the fact that they have borrowed too much and are now found to be in too much debt that they cannot afford to pay & now they can understand the fact that this the dawn of the new age where low Growth & austerity measures imposed by the government would be the most common features. So how the West get into this Mess?? We have initially discussed about the cheap salaries in the developing economies compared to the developed ones. So the NVC Lighting's Unit in UK is merely a distribution unit of products manufactured in China where the economy is booming (obviously cost-leadership is being followed). So we can see that the developing economies are becoming richer & the Developed becoming Stagnant. I think they can blame Greedy Bankers & high spending Governments of the west but also there are deeper causes. So lets go deep. In 1978 Deng Xiaoping became the leader of China which was disastered for several years. China was just emerging from the lowest point in their growth for the last 100 years. Deng severely transformed China by introducing elements of Capitalism into Communist China. Here is one of his famous Dialogue — " it doesn't matter if the cat is black or white as long it catches the mouse" which means it doesn't matter if China is communist or capitalist as long as it becomes richer. In early 1980's on its way to becoming the world's 2nd biggest economy under the leadership of Deng, Britain was <https://assignbuster.com/how-west-went-bust/>

following the other way round. There were many lockouts, unemployment was a serious concern because of low growth & wage rates weren't increased. Then Britain got it's new prime minister who like Deng destroyed to de-regulate, cut taxes, let the market free. She felt the state had become far too dominant and wanted the private sector to run the economy. She is Margaret Thatcher (longest serving prime minister of UK, of the conservative Party) This British government did the same thing as the Chinese, but what went wrong for them?? In the Britain & the US, manufacturing employment slumped in the 1980's. The Thatcher's British govt. & the Ronald Reagan's US govt. did the same mistake of assuming that the markets were self-regulating & efficient & also thought that the private sector could do no wrong needed no Regulation. Because of this, they could cut taxes, the economy would produce a lot of revenue. A lot of this was just ideology. In 1986 Thatcher's love of free markets unleashed a Financial revolution called the BIG-BANG. It created the modern banking system which in 2008 came near to bankrupting itself & everyone. Big-Bang allowed Big international Banks to buy stock broking firms High street Retail banking was combined with much riskier Investment Banking & large Financial Conglomerates were formed Because of this immense money was flowing in that time, salaries were rising, everything became magnified by huge amount. Then these banks were involved in hedge funds etc. and were involved in much complex concepts like delta-one trading, London was becoming the Leading Financial center. The rise in the number of financial services in the 1980's & 90's and as manufacturing shrank, this seems to be the answer for a country struggling to compete in the world. This created an economy that now seems to be unbalanced & unable to grow. The important repercussions of the

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ideological implications of Thatcher's & Regan's Govt. were, in the free market society which they eventually created, rises in the salaries of top officials was huge. Banks & Financial firms took bigger & dangerous risks to generate more profit & to pay more wages to top officials. The gap between the poorest & the richest widened a lot which was similar to the Victorian Era. The ratio of pay for the top executives to the middle workforce was stable in the throughout the 20th century until the 1980's where the ratio almost went as high as 25: 1. Today it is 150: 1, which is almost six times compared to 25 years ago. It is simple breakdown of basic morality. It is simply corporate theft. The real wage growth of a typical American Worker in terms of take home pay was 0 since the 1960's. So in the 1980's, Britain deindustrialized & in the same period the services sector grew faster & also the high end skills were better rewarded & valued. So that meant that if you do not have the high end skills, your salary would be low as you are not the high skilled worker & these kinds of jobs were being done much cheaply by the Developing Economies. So the point is as the income was going down, many people were unhappy as their standard of living went down. So they didn't know what to do. Then came the answer. Consume as if you were earning more. Take debt!! The financial revolution spawned Debt revolution. In a de-regulated economy like Britain then, everyone could have a loan & a credit card. Their incomes were growing slowly but their standard of living went relatively high up by borrowing to buy. Debt suddenly transformed from risk to a must. Suddenly throughout the economy people were borrowing too much as compared to their previous periods & this was went popular throughout the media. Money became an obsession. If the people at the top are offering that as a model, then the people at the bottom were

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certainly influenced by it. People at that time believed that housing prices would always go up. So people took huge debts, loans which they couldn't afford to. Also people were becoming richer as their property prices were going up. So this might have led them to consume more by borrowing more. Deng Xiaoping's relaunch of economic reforms in 1992 has resulted in two decades of extraordinary growth. In the past ten years under the current leader, Hu Jintao, the economy has quadrupled in size in dollar terms. A new (though rudimentary) social safety net provides 95% of all Chinese with some kind of health coverage, up from just 15% in 2000. At that time during the latter half of 1992, Deng Xiaoping also took some other reforms & opened up the economy. So the Chinese economy expanded 6 fold in the last 20 years. During that time Britain was spending most of its money. During 1992, Premier League was launched. The 1990 spending spree was the starting of the longest, rapid & uninterrupted period of economic growth. The point to be noted here is they cheated to win i. e. they were spending the money which was borrowed. You can ask as the prices of the properties etc. were rising & inflation would have risen to keep that in check. Then why didn't it happen? They have to thank the Chinese as they were producing goods for cheaper rates. Also the pound bought more & more as its value was increasing. So they could buy more & more of Chinese goods. Even politicians like Tony Blair, Bill Clinton couldn't find Debt to be wrong. It was easier to win the elections if the country felt richer. The time when Tony Blair came to power, in the 1997, this was the first time when the markets showed signs of a crisis. The Asian economies like the Tiger economies (Thailand, Malaysia, South Korea) borrowed too heavily from the overseas to finance their development. They couldn't repay those Debts. These countries initially

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had people saving their money but ran budget deficits. To finance their development they borrowed more & more. They suddenly found their Banks under attack, their currency under attack, wholesale unemployment without unemployment insurance. As west investors started to dump the local Asian countries, their economies slumped. So after all this happening, these governments said NEVER AGAIN. They said they were never going to get in a position such that outside financial markets would have such an impact on the economy. Across Asia, governments vowed to generate wealth using their own resources, export more to other nations & also to save & invest. An average Chinese would save almost 50-60 % of their income. They did this because they were quiet insecure about what would happen to when they get old, when they do not get pension. Whereas in Britain many people don't save anything may be because they have a good national health system. The Chinese consume half as much as Britain does compared to the size of their economy & save much much more. In the decade before the crash, many vast exporting nations like Chinese, Japan, Germany led their surpluses to the consuming world like US, Britain at a price of trillion dollars every year. The west were thinking that encouraging consumption would encourage growth. So the mindset at that time was like, the developing economies wanted export led growth. The developed economies like US, Britain, Spain were spending & consuming much of which was brought on credit. So overall, economies like China etc. were manufacturing more & more whereas economies like US, Britain were consuming most of it much of which was financed by Debt. And also the standard of living sky rocketed during the booming periods. So to obviously finance themselves during recession times, they took much of debt to maintain their standard of living.

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For example of how much debt was taken, during the time of Big-Bang the total amount of debt (Mortgages, Credit card bills, Loans) was something around 177 billion pounds which now turned into 1 1/2 trillion right now. This is more than the value of what Britain Produces in a single year. If the interest levels would be turned to anything like normal levels, the interest burden for average people would be crippling. On an average, a Britain adult would be 30k pounds in debt or 165% of his after tax salary. But it was not only the people who took too much borrowing, the western banks also borrowed recklessly to lend to us, taking dangerous risks to inflate profit & pay. The banks borrowed extensively from overseas to finance the consumption in the economy. People, banks, companies & government borrowed when money was cheap. The money was not flowing into the east where opportunities for investment were high. Instead they were going uphill not to finance investments but to finance the consumption. The developing & emerging economies have fixed exchange rates. So when they want to keep their currencies cheap, they buy up Dollar assets. So this pushes down borrowing costs in the US making it cheaper for the Americans to borrow even though they are already indebted. And also here we have to notice that these US, UK were borrowing too much for consumption of goods made by emerging economies. These US, UK & the west were able to borrow at cheap interest rates as the east was saving so much. There was a tremendous housing boom picking up as these Industrial countries were having low interest rates. Even Ireland, Spain were building many houses & were on a spending Spree. These people were borrowing too much as their house prices went up. So they felt richer & also the financial sector always said Housing Prices are never going to come down. But it did happen. That's

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when the party ended In 2008 Lehman Brothers was bankrupted after billion pounds losses. The property crash,