The Crisis of Crises
and what it means for anarchists

From high finance to peak oil, to climate change, the world is seeing a convergence of numerous crises. We join the dots and look to the future.

a dysophia publication

Crises are fashionable in the environmental and left-wing movements. Every few years there is a new topic of debate on the problems facing us if we go down our current systemic abuse of global resources. It would be impossible to draw out a comprehensive list, but pollution, peak oil, fossil fuels, fossil water, genetic modification and the big one – climate chaos – have all been talked about to various degrees and accepted as issues on requiring action.

Into this we can now add the currently ongoing financial crisis. Though it is no longer dominating the headlines, governments in the West are still trying to shield their populaces from the effects of it, and the worst is possibly still to come.

As we write, nations such as Iceland and Latvia are struggling from economic collapse, and the big question troubling economists and politicians is whether the recession is going to kick back. There is much excitement over tentative signs of recovery, but how sustainable it will be is hotly debated.

Thus, the purpose of this pamphlet is two fold:

1. To outline broad economic trends of the last decade and give you some insight into the main financial indicators that are going to affect the next few years and what they mean in practical terms.

2. To show how these will affect government actions, and thus our capabilities to respond to all the other crises that are coming our way.

It is fair to say that the next five or so years are likely to be very interesting if not outright challenging. To complicate it much further, it is increasingly apparent that we cannot separate out our responses to climate change, peak oil, etc from what is happening in the financial world.

Underlying many solutions proposed by institutions, governments and often grassroot movements, is a set of unrecognised assumptions. This results from a fundamental lack of understanding of how our society is structured. It is not sufficient to say that capitalism is not working, it is just an important to realise that physical infrastructure from logistics to sewage systems also play an important part, and in turn this brings in other issues such as weather and resources. To see the interconnections we need to re-examine the world from a wider view-point than we are accustomed to.

Any analysis which does not take into account how our society has developed precisely because of access to cheap oil, energy, water and stable weather is going to fail future tests. Crises are converging and we need to be aware that much of the effects of capitalism is actually hidden from view, and that many of our preferred solutions still rely on it in ways we do not yet fully grasped.

The Financial Crisis

Though commonly referred to as the *Credit Crunch*, the current financial crisis is less about a loss of credit than it has been about debt. The periodic *crises* in capitalism are well documented regular events. They are based around *speculative bubbles* - where investors get excited about a new industry, pouring money into it in the hope of making ridiculous profits once it takes off. This creates an unnatural situation where the sheer quantity of money invested distorts the market, but nobody wants to be left out. Some times it works, but more often than not the market "overheats" and the bubble bursts under the pressure of expectation.

Mostly it is the rich who get burnt with only indirect effects in the wider economy, but there are powerful side-effects all the same, and not just because it drains money from other parts of the economy. The Act of Union which deprived Scotland of its own government in 1707 was brought about by the Scottish ruling classes being ruined because of their heavy investment in what was known as the *South Sea Bubble*, one of the biggest speculations of its time. The government in London bailed them out on the promise that the Scottish peers agreed to the Scottish Parliament being abandoned.

However, like the Great Depression of the 1920s, the current crisis is found on the reckless behaviour of banks themselves. With historically cheap interest rates, borrowing money became much easier. However, to make a profit you want to lend it back out at a higher rate of interest - the profit coming from pocketing the difference. Therefore, banks and other financial companies began pushing debt as as their main way to make money.

When there is a short term view point, and the overall value of business deals is what dictates bonus size, there is no time spent considering what would be the effect even five years down the line. So when you have 7% interest rates on mortgages from people with good credit ratings and 14% on those with poor ratings (that is *sub-prime*), you go for the latter.

The debt that was used to fund the credit boom came from the ordinary person in the street. Sub-prime mortgages were just one example of the encouragement to get people, and even corporations, into debt. Consumerism became a way of life, and we were told it was all going to be fine because interest rates would remain low.

Companies were encouraged to grow to generate business and to take advantage of the consumer boom, but this growth was based on the available of cheap loans to expand – which was fine as long as the economy continued to grow, as the profits from the companies was anticipated to cover the value of the loans.

Private investment firms such as hedge funds resorted to even more cynical strategies, buying up otherwise healthy companies using cheap loans, and then through financial manipulation extracting the anticipated future profits from the company for themselves, which resulted in the company being loaded with future profits having to pay off.

This growth had to be fed by cheap goods for people to buy. And goods equates to factories consuming ever greater water, oil and other resources, whose capitalist owners needed these supplies to be cheap so they could keep profit margins high. The system also required cheap labour to produce the goods, which has lead to the exploitive practices such as sweatshops, and effective economic slavery.

Many social and ecological problems highlighted by NGOs in waves of publicity over the last two decades have clear roots in the consumerist boom of the wealthy countries of the Global North. The war in Iraq, and the arming of the Nigerian government by Shell are just prominent examples of an insidious process happening across the world where the needs of global businesses have been used to disrupt indigenous peoples and ecologies.

A set of industries have grown up around this debt culture. The UK in particular grew strong on the back of this, a process accelerated as a result of Thatcher and *neo-liberal politics*, with the service and finance industries replacing manufacturing as the dominant players in the economy. Other countries have embraced similar models, but few as completely as Britain.

So when the governments talks of restoring confidence and bringing the system back up, its means returning to the same levels of consumerism we in the Global North have been enjoying for the last couple of decades.

However, to step back a bit, the bankers did not stop with taking profits from consumer debt and mortgages. The consumer debts and mortgages were parcelled up and sold on to other institutions with the promise of the wonderful returns that would be available when the sweetener deals of low interest rates on the debt in place for the first few years stopped switched over to double figures. This process was basically gambling using the anticipated future profits made from the debt for the down payments. And this was just the simplest of the various financial products devised to take existing income streams and turned them into tools of making yet more promises. Sub-prime mortgages were the foundation for many of these type of deals, so when they turned rotten the whole system was affected.

Through leverage, bankers and hedge funds bet on everything possible and did so without thought for the wider picture. They did this time and time and time again, until this *shadow banking* world was worth trillions and larger than the actual banking industry which traditionally focused on straightforward savings and loans.

One cannot underestimate just how much of this world was gambling, or making money helping others gamble. It was all happening behind the scenes, and even the regulators such as the Financial Services Authority in the UK, or the Security and Exchanges Commission in the USA had little idea how big it was, or just what was happening.

And as with all gambles, it relied on the confidence that prices – shares, wages, commodities – would all continue to rise forever, as capitalism, it was believed, had managed to sort all its problems out (as long as you were in a rich country).

It was even dressed up as a way of safely dealing with risk. Any loan carries risk, and the interest rate is set on how likely it is to be paid back – the greater the risk, the higher the interest rate. This simple idea was turned on its head, and risk itself became a product that could be sold and used to turn a profit. Risk became part and parcel of the way of making money, and because of the high returns investors became more and more greedy for it, believing that through the complicated financial products which mixed up low and high risk debts they had off-set any real danger of being exposed to it.

Only belatedly was it realised that the risk was increasing throughout the entire system, and not simply going away as had been argued. And, like a minefield, it turned out to be absolutely everywhere.

The collapse could have happened at any time, but it was the sub-prime market which went first, hence it is the best known of all the debt industries that played a role. What happened is that mortgages had been massively over sold to people who could only afford them while the interest rates on them were kept low. However, written into the small print was that after a few years they would seek large hikes. No longer able to pay, the number of defaults throughout the US, slowly and quietly began to rise.

The debts they had been depending on to help fund their various deals were turning into empty promises – in the jargon, these debts had become toxic, not just because they were bad in themselves, but they were affecting a whole other raft of financial products at the same time.

It was realised that the financial institutions were sitting on a vast quantity of toxic debt that might never be repaid. Hundreds of billions of dollars worth, and worse it was so convoluted they where not able to work out how deep the problem went. They lost faith in themselves and also with other financial institutions. If they were in trouble, then that meant everyone else was likely to be just as precariously balanced: confidence went, and the lines of credit used to generate the short term debt the business world was dependent on to keep paying for things disappeared. Once started this became a downward spiral that infected the entire business world as well.

With the encouragement of banks, many companies had taken on huge debt either through mergers, or by being bought-out, naturally financed by the banks and other finance companies, for whom it was a source of income. While there was growth this was fine as the debt could be paid off from the profits; with a down turn, that was no longer the case as there was not as much money coming in. With the banks in trouble, they were unable to continue helping companies cover their debts and reined in the lines of credit. It did not matter if a company was profitable on its ordinary day to day business, if it could not service the debt it had been saddled with then it was in trouble. It was forgotten that financing expansion through only works when there is cheap credit, and that was now gone.

Governments step in

With the golden boys and girls in the financial industries in trouble, governments had to act to protect capitalism, as the only ones left up to the job. The investment banks were failing but every financial institution from pensions funds to the high street banks were in just as deep and were in danger of going into death spirals.

Businesses and councils would not have the credit lines needed to pay their staff. Pension funds would have gone under. Credit cards would have ceased functioning over night. All savings would have been lost.

This is not exaggeration. These banks really were too big to fail and capitalism witnessed for the first time a situation where its neck was on the line because of its own behaviour. The market place had failed all the promises the neo-liberals had made in its name.

Governments had no choice but to step in, putting in place guarantees to stop the banks from failing. Economics dictated their actions; the choices they pretended to have were never really there. They promised to support them to keep them alive, to open up new lines of credit that were to be passed on, and to make sure that people did not lose their savings.

It worked, but it came at a cost, and it is the public who now bear the cost, the huge debts the governments accepted on their behalf.

We will mostly focus on UK financial problems, but the pattern is repeating across the globe. The banks had borrowed and lent out on levels far greater than they were capable of handling. With the world going into shock, that ability to pay back (known as *servicing debt*) also shrunk and the downward spiral continued.

Ireland, Iceland, the Baltic states are simply at the forefront of a process that is happening across the globe. With much less in the way of resources to buffer them, they have been hit hardest, early on, but many other countries are slipping the same way, spending their reserves propping up their economies. This is why the world is looking to China and India, hoping the growth of consumerism in those countries will be strong enough to prop up ailing Western economies.

There is debate over whether the governments moved too late or not, but either way what they were doing was simply trying to slow down the deceleration of the global economy, hoping that they caught it in time before it went critical. Though it is no longer front page news, the crisis is not over yet. There are more aftershocks due in the next few years. The outcome is unpredictable, but in the next section we will introduce some of the trends that shape the UK's ability to react to them.

We have simplified a lot above, but the broad trends are there to see – debt laden governments and a shift of global geopolitics to the likes of principally China, but also Brazil, India and Russia (the *BRIC* nations). This is one of the main factors as to why the G20 group of nations is now a more influential institution than the G8.

Introducing the Debt Markets

When it comes to the financial world governments are treated the same as corporations, especially those following the *neo-liberal* model, such as most countries in the traditional West have done. The only difference is that through taxes they have a guaranteed income stream.

The UK government, like other European powers, in the eighteenth century realised that all the wars of expansion were proving to be very costly. It needed ready cash to pay for weapons, transport and the wages of its soldiers. So they went to the banks who supplied the finance in return for promises of future dividends on that debt. This is how the banks such as Barings, Warburgs and Rothschilds made their great fortunes.

> *A **bond** is a promise to pay back interest over a length of time on an amount of capital provided to the company. When that company is actually a government, then it is known as a gilt. Essentially it is a glorified IOU with promises of profit on the money loaned out*

With a government, the received wisdom is that they for the most part do not fail. Investing in gilts is seen as a guaranteed income but one that does not have high interest rates, volatility, or excitement attached. However, many pension funds and other governments see them as a way of protecting themselves against rainy days and also ensuring the absolute value of their money does not go down.

Thus, China currently owns $1.4 trillion of US debt, and the Middle East as a whole $1.7tn. The UK government is likewise indebted.

> ***Volatility** – how much the price of something will fluctuate; the more it fluctuates the more city traders can make money on it; high volatility also indicates some instability in the market around either a company or commodity supply or even a government.*

What is particularly important about debts such as bonds is that they protect the value of the money invested in them, which is what makes them attractive to investors. If the interest rate on them is higher than inflation rates, then they will increase the absolute value returned. In this case, the person paying back the debt will have to work harder in order to be able to afford the interest repayments. This feature is one of the key mechanisms which makes capitalism inherently exploitive, and why usury is considered immoral by many societies. Once you are in this cycle you tend to be at the mercy of the people who made you the loan.

Understanding how this works will give you a strong insight into how the capitalism model works.

A debt of £10 in 1970 was a lot; today, because of inflation, it is very little in real terms. This is because what the £10 would have purchased you then, would cost a lot more now. So the question is how to make sure that £10 increased in value over the intervening years so that at the very least it would purchase the same amount of goods today as it did in 1970? For example in 1970, £10 would have brought you 110 loaves of bread. Today, it would buy you 7. In terms of keeping yourself fed, that is a big change.

How much goods your money can buy is known as its *purchasing power*, and is an important concept for when we look at currency exchange rates. The measure of how purchasing power changes is the *rate of inflation*.

If you simply kept the £10 under your mattress, you would be effectively losing money, as its purchasing power declined over time. To maintain its purchasing power you need to invest it in a way that it gives an income on it that you can add to the original amount. This can be a savings account, or it can be any investment which promise an interest rate that at the very least matches the rate of inflation – preferably higher if you want a profit from it.

Thus, if you invest your £10 at 5% interest rates, each year you make 50p on it. After your first year, you now have £10.50. After two years you have £11, and so on. This being the financial world life is not quite that simply, as interest rates will change, interest can be applied in different ways, and so on. The key thing is that your basic investment is increasing in value so that it can continue to purchase the same amount of goods it would have done when you first made it.

Understanding this process will give you a lot of insight into the basic motivations of the financial world, who are as much concerned about seeking to protect the values of their investment in the global money markets as they are to profit from it. Indeed, for a long time simply protecting purchasing power was the prime motivation, but the financial changes made under Thatcher and Reagan opened the worlds eyes to how profits could be made at the same time, not from the production of goods, but by moving money itself back and forth.

To illustrate further, sticking with how many loaves of bread our money can buy each year, lets assume a very basic model where inflation rates remain at a constant 5% year on year. Then the difference in purchasing power of £10 left untouched, and £10 invested at 5% changes as follows:

Year	**£10.00 left untouched**	**Number of Loaves**		**£10 @ 5% per year**	**Number of Loaves**
1	£10.00	1000		£10.00	1000
2	£10.00	952		£10.50	1000
3	£10.00	907		£11.00	1000

Setting Interest Rates

When we hear of Bank of England *base rat*e (or the base rate of any central bank such as the European Central Bank, the Federal Reserve, etc) it is essentially setting the payout to be expected on gilts. So if base rate is low, then gilts are not interesting to investors seeking to make money, which makes it hard to attract people willing to make loans to the government.

Furthermore, a necessary function of gilts and bonds is to protect the purchasing power of money through the use of interest rates, otherwise they become unattractive to investors. Practically, this means they are closely tied into the rate of inflation. If inflation goes up and base rate doesn't the value of the money invested goes down and investors run away.

Base rates are fundamentally important to the financial world - banks, mortgage companies and even insurance companies and pension funds all use it. It is through these mechanisms that the base rate affects the rest of the economy. There are few markets that it does not ultimately affect.

A secondary use of base rates is to measure how much other interest rates have deviated from it, as this is a useful indicator for there being problems in the system.

Interest Rates & Inflation

Generally changes in base rate lags behind inflation, but they are intertwined through how base rate affects other interest rates, which are in turn passed onto consumers base rate levels will affect inflation in turn.

During financial crises the normal patterns will break down for a while due to central banks and governments intervening in order to manage part of the economy. However, this can only be a limited intervention and the longer it goes on the more trouble is stored up.

There is a natural cycle taking place here, and because inflation and interest rates are so intertwined predictions can be made. For instance, if inflation goes up, then ultimately base rate will have to rise, putting further pressure on the public who are exposed through credit card debt, car loans and mortgages.

However, inflation is affected by other issues, often on the global scale, so real long term control remains in the realm of the global economic situation rather than the short term efforts of the local governments and banks.

This is one of the reasons why governments are so scared that others will take a protective point of view, as this brings a lack of unity that hampers guidance of the wider the global economy. An example of this was when Ireland offered to guarantee all the savings in its banks. Investors threatened to decamp *en masse* to Ireland which would have hurt the UK and other countries greatly through their banks losing much needed capital in the form of savings. Thus global economic pressure forced the UK and other governments to follow suit to prevent a crippling outflow of money.

UK Government Debt

Currently the UK Government is running up a vast debt on our behalf. Besides having to bail out the financial sector by agreeing to underwrite toxic debts, there is still the day to expenditures, already partly financed through borrowing. It also has to pay wages, and meet all its existing commitments such as the NHS, education and defence.

A significant source of government revenue comes through tax on profits – VAT and company tax. The shrinking economy has hit this hard – the financial services sector at one point formed 15% of the gross national product and so its overall contraction has opened a hole in budgets. The housing market contraction has done likewise. The Government has tried to stimulate consumerism in order to halt the downward spiral through cutting VAT and car scrappage schemes, but both take money from the budget.

Gordon Brown once boasted that he had created a system which eliminated the cycle of economic boom and bust, trusting in the market place to sort out any problems. Due to this he spent most of the existing government reserves, so there has been less money stored away to fall back upon when the shock hit the system.

The result of declining income and poor reserves means the Government is forced to borrow more than ever before, quadrupling as a result of the crisis. The proportion of government debt to the Gross Domestic Product (the total income generated by a country in a given year) is increasing to points where economic institutions are sounding warning bells. In July 2009 it was at 56%; the Government estimates it may go as high as 79% in 2010, while the International Monetary fund warns it could reach 100%.

The problem is that if it does not borrow so much it cannot meet its existing commitments. The simplest way to reduce its borrowing is to cut its expenditure, but that is very politically sensitive, especially with an election coming up in 2010.

It is further complicated by the fact that in the UK government spending forms a significant part of the economy in the first place. For 2009 it is estimated at 45%. There are a lot of jobs depending on the NHS, military and so on, so cuts in government spending will have further knock on effects on the economy as a whole.

The government argues is that it will be fine once the world comes out of recession and growth continues as “normal”. Revenue will increase, so it will be able to pay off the interest on the debt and the capital itself. That inflation will reduce the value of the debt in the long run, and so on.

It is a big gamble, and power over what will happen globally is not within its grasp. It is complicated by matters such as currency exchange rates and access to resources. This debt has to be paid for, thus it is taking money from the future. As such it will will play a pivotal role in how we are able to handle the other crises facing us. Once you start taking into account climate change, peak oil and geopolitics, it will hamstring the UK.

Rolling the Dice on Debt

So, how likely is the UK Government to win its gamble? It is impossible to say, especially given there is quite a number of factors, all interrelated, and which in some cases have contradictory effects. This is the fun and games of economics that vexes the even the brightest economists.

It is possible to speculate a lot here, but in the end all we can only look at trends and make educated guesses. Even computers struggle to merge all the different variables into model that predicts well, especially with intangible factors like public confidence to account for.

Confidence

Public confidence is remarkably important. If the public are nervous about jobs and interest rates, they save rather than spend, so reducing the amount of money returning to companies, whose profits in turn feed the financial industries. More saving also means more interest banks need to pay out. Stimulant measures such as car scrappage schemes are short term only. Those who can afford it take advantage of it early on so its effectiveness quickly wears off.

Saving has some benefits to an economy in recession – it stabilises the banks, gives them more money to invest in new business deals and so on. The question is whether the savings are sufficient to support the system, especially when it is clear that so much of the population are addicted to debt in order to maintain their lifestyles.

For years banks ignored basic economics and over-stretched their balance sheets with debt. This is a problem in itself, before one gets into the increase risk of loans defaulting as happens in an economic downturn. The drive for consumerism has meant that though there are more savers than those in debt in the UK, the total debt still outweighs the value of the savings. A net debt is survivable as long as the economy is growing, but in a weak economy it can become a significant threat to its stability and unnerves investors.

Governments had no choice in bailing out banks as the systematic loss of confidence was causing ordinary banks to fail since they relied heavily on short terms loans from the global money markets to see them through day to day – their collapse would have wiped out pay-checks and savings.

If companies do not feel confident about the future they cut back on their inventories, playing havoc with their suppliers. Loss of confidence also means it is harder to get lines of credit, while those hard against the wall will struggle for support from banks and investors trying to cut their losses.

Confidence is key to the system, which is why commentators get so excited by signs of growth as a way of measuring its return.

Green shoots

The problem is that the commentators are reading at lot into figures that are easily distorted because the volumes of sales are so low, that a single abnormal event can have a disproportionate effect on the figures. In a standard system anomalies are averaged out, but in a low volume system they have the power to greatly change the average itself.

A so-called green shoot may just be a change in the rate of decline, not a growth in itself. Just because the bad figures are slowing down, does not mean they are getting better or that they have reached the bottom, simply but that they are getting close. They could remain on the bottom for some time. Nor does it account for the fact that at the bottom of a market there can be apparent significant rises relative to recent lows, before further falls happen. Markets have to be taken as a whole for predictions to hold weight.

Property Prices

House prices is an important economic player as mortgages are the largest single debt most people have. With house prices having fallen, it removes a large chunk of money from the economy. People with mortgages worth more than their houses are currently valued at (called *negative equity*) are far less likely to spend. People "unlocked the equity" in their houses by taking out new mortgages that provided easy access to money. This was a significant source of seed money for the consumerist boom underpinning the recent financial speculations, both in the mortgages themselves and in providing access to ready cash home owners to spend on holidays, etc.

As well as mortgages, housing also drives another significant player in the UK economy, the construction industry. Thus low prices in the housing market will cause it to stagnate and drag heavily on the rest of the economy.

The current house price fall may also be followed by a commercial property price collapse, something which will hit the big suppliers of finance who have sunk a lot of money into it over the last decade.

Private Debt

Private debt, both of individuals and corporations, is another ticking bomb under the UK's financial health. Companies are used to budgeting for low interest rates, and it has become common practise to ignore the clauses that put up the rates after a few years. Others are simply short term loans. The assumption is that you simply just re-finance though other sources on just as low rates, that is get another cheap loan to pay of your existing one, so you do not have to pay back the capital in one go.

These *roll-over debts* as they are called, are start coming due over the next few years. However, the debt crisis means this refinancing will be harder to come by and at higher rates than planned for, causing pain for people and businesses alike – at the time when the Government will be expecting to see a recovery to deal with its own debt.

Hence the pressure to keep rates low. However, low rates are unsustainable when there is such high levels of debt and there are a number of financial aftershocks still to come once the wider effects of the crisis trickle down.

The Exports-Imports and Sterling Exchange Rate Tangle

Exchange rates is how the purchasing power of Sterling relates to the purchasing power of other currencies such as the Euro or US Dollar. To make money the country needs income (ie. revenues). In basic terms this translates to exporting manufactured goods and services. For this to work the price of goods in the UK need to be competitive with the rest of the world, and prefers low exchange rates.

Low exchange rates however mean that the ability to buy in the resources to make those goods is hampered as the Sterling does not buy as much. It is a difficult balancing act at the best of times.

With large amounts of money going to service debt, foreign investment is a crucial source of money to grow the manufacturing and servicing industries, and investors are also concerned that the value of their money is being preserved. Which is jeopardised by a falling exchange rate. This will make life more difficult for a government seeking buyers for its own debt.

High and low exchange rates have different beneficial effects for the economy, so there will always be arguments in favour of each. However, there is a well established theory called Mundell-Fleming which basically says that at any one point the government can control two out of three of

1. its *fiscal policy* (tax rates & spending);
2. *capital flow* (people taking money in & out of the country);
3. currency exchange rates

What Government cannot do is achieve all three at the same time. It can tinker in the short term but their will always be a rebound. We shall not go through all the permutations here, but the point is that the UK Government's ability to act later on is tied by the decisions it is making now.

At the moment it is keeping a control over its fiscal policy by increasing debt to allow tax breaks and avoid cuts. The low base rate, needed to stimulate the economy is discouraging investors, so the third factor, the value of sterling is falling as a result. This means the purchasing power of the pound is dropping. In turn the cost of servicing foreign debt is going up, adding more to the bills faced by debt laden companies and the Government.

The books are becoming harder to balance. It is very hard to get right, and simple to get wrong. The politicians for once are little to blame as whatever they do, they are going to be damned on some front.

If it gets it really wrong, and the economy lurches even further downwards, as is increasingly looking likely, then the creditworthiness of the nation itself becomes under threat. As a leading western economy, the UK has enjoyed a triple A investment rating, which basically says its is a safe bet for putting your money into. This is now under threat, and a drop in credit rating means that many of those buying debt will pull out and everyone else demands higher interest rates to cover the risk. And that ultimately leads to increased interest bills for the Government and inflation, both of which are bad for the economy.

The Pensions Crisis

2012 is the beginning of the baby boomer generation leaving employment and taking their pensions. A big question exercising the minds of the economists looking at this is whether there is enough money to fund the payouts they are expecting?

Pension funds are rarely in a healthy position, not even when times were good. They are very exposed to the share and bond markets, and the crisis has left them with large holes in their finances. Should the private pension system start to fail, or is unable to meet the demands of those who have taken out policies with it, then the government is left taking up the shortfall.

In economic terms, pensioners consume more of public finances than they put in, as they do not produce goods or services, while they requiring people to look after them as well. Increased life expectancy means that the strain on the system, especially the NHS, will last even longer. Another problem for the economy, is that the retired generally spend less and save more.

This is not to say that we are against pensioners, but that from an economic point of view ageing populations do raise problematic issues, especially when the Government is in the situation of having to fight on multiple fronts all demanding funding, or cuts in the services it provides.

Unemployment

Figures for employment generally lag a year behind those of the rest of the economy. For example, the fall out of the worst of the financial crisis seen in 2008 is only now becoming apparent in the dole queues. Likewise, rises in employment is not going to be seen until a year after the economy starts rising out of recession.

However, in the meantime the unemployed are both taking from government coffers while not contributing to the economy. Increasing employment takes money, private and public, to finance expansion, research and development, and to establish new businesses. The questions are whether the governments can provide the public money, and if banks and foreign investors have enough faith in the UK to make that investment. With greater opportunities available in new industrialized nations (eg. India), and questions over the UK's financial stability that funding is not guaranteed.

An alternative is the *New Deal* approach, in funding massive infrastructure projects. However, there is little scope for that left in a mature country like the UK, and the consequences for the natural environment are frightening.

But what about tax cuts?

The other way of stimulating the economy available to the government is tax cuts. This is very unlikely to happen, as it would have to raise even more in loans to cover expenditure.

The cut in VAT to 15% was a short term measure to encourage consumers back into the shops. However, in 2010 it is due to go even higher to 20% to make up the short fall the existing cut has made in government revenue. If there is not a well established period of growth by then, and a return of confidence then this will do more damage.

Not to put up VAT blows an even bigger hole in the government's budget and may dent confidence of foreign investors as it shows the government is not seeking to tighten its own belt.

Deflationary Pressures

The opposite of inflation, deflation is when the cost of living actually falls. There is concern that the UK and some other European nations are in danger of dropping into a period of negative growth – that is the economy shrinks.

In the immediate term, this is good for consumers as it means their money buys more – but only for those who have the money to spend. Those with debt have a bigger problem, for as the value of debt falls under inflation, it increases under deflation.

This will create more problems for the UK. Not only because its debt becomes bigger, but because deflation means that the economy is not growing, and consumers are not spending. Investors will not give their money to an economy that does not give them growth.

As we write, economists are arguing which is coming, deflation or high inflation, but nobody can be sure just yet. Neither is particularly good.

Insurance Companies

For insurance companies who have to make pay outs, deflation is a major danger. Though hit by falling share prices, they have been well protected against the financial crisis, partly through lack of Hurricane Katrina type events. However, if deflation sets in it could send a wave of bankruptcy though the insurance industry.

The problem, is that it is very hard to do anything without insurance these days, and increased premiums will further depress the economy. One of the important unseen functions of insurance is backing business deals. If a bank loans to a hedge fund to make an investment, or extends a credit line to a retail company to purchase the next set of goods to sell, it will take out insurance in case the hedge fund or company cannot pay the money back. When you are talking billions upon billions this makes business sense.

But what if the insurance companies cannot pay out, or are no longer able to offer the insurance in the first place? Most people will have heard of Lehman Brothers going bust, but at the same time the worlds biggest insurance company AIG was also collapsing. It insured something like 90% of global business deals. If it had been allowed to collapse then the financial world really would have gone into total meltdown.

Insurance allows a degree of confidence by shifting the risk elsewhere, but only if the insurance companies themselves are financially sound, and they are not out of the woods yet.

But the banks are making profits and stock markets are rising...

The situation is more intricate than simply assuming that a growing economy means growth in profits and share prices.

A lot of it is built on the assumption there is demand and growth around the corner, so now is the time to start buying up low prices stocks. Once again it is belief and confidence running the show. It is being driven by profits coming in from companies with a large global presence, such as oil and finance. Oil shares are doing well because they have found reserves, financial companies because as they are profiting from advising the debt-laden companies they got into trouble in the first place.

There is also hope that countries such as China are helping stabilise the world economy by changing strategies in "emerging" markets, so giving the promise of growth there.

A third, lesser known effect is that as a currency drops in value, the stock market rises, to reflect the change. Once the shares become cheaper relative to their absolute value, foreign investors come in and push up prices. Connected to this is the value of the pound to other currencies, in particular the dollar which is falling, so what is happening in the US is causing funds to flow into the UK, but this is likely to be temporary.

None of this actually creates wealth. It is all dependent on a return to growth, and fuelled by low interest rates meaning that once more there is cheap funds to be had. This is potentially another speculative bubble, and if consumer markets do not recover at the same speed, there will be a fall back in prices. Many of the companies reporting profits are not doing so on increased volumes of sales but through price rises and cost cutting measures, so there is little actual consumer based growth taking place.

That governments such as the UK & US are increasing their debt to protect their economies in the short run is also distorting the markets who have yet to factor in the effects of cuts.

When you look at countries like Japan, which have gone through this sort of financial crisis before, 50% plus rises in the stock market are not uncommon, but there are always significant corrections a year or so later. Currently we are still quite a way off previous peaks in the stock market.

Other economic fears

1. The banks are still not leading. A year after Governments propped them up, and basically started printing money on their behalf (hence *quantitative easing*) credit continues to shrink. This impedes consumer spending and slows down business expansion.
2. Growth cannot just take place in one industry; to be stable and be a genuine reflection of the economy, growth must take place across all sectors.
3. That the next generation of consumers will become savers rather than spenders, withdrawing capital from the markets, so again impeding growth with an end of the consumer boom.

Is there a way out?

Its all pretty scary stuff. The UK economy is in a pretty shaky place and there is plenty of stuff that we have not gone into here that have still to be faced up to.

The main point is that the government is engaged in very short term thinking so storing up lots of problems for the future, particularly high interest rates. We hope that by reading this you have a somewhat better idea of why currency exchange rates, Bank of England base rates, housing prices and the like are so important to the economic health of the country.

Like us, you may even think, well bloody great, its about time capitalism got what was coming to it. But the real point is that the world the UK has been existing in for decades is coming to an end. There is a chance that what is happening to the likes of Ireland, Iceland and Latvia will happen in the UK. It is unthinkable, and may not yet happen – the world is too unpredictable for that - but it is a possibility.

Certainly, the UK is in danger of being edged out of the first tier of players in the financial world to which its has pegged its well-being. What is only now being realised is just how much of our standards of living have been dependent on that position. There are major geopolitical shifts with the rise of the BRIC nations as players in the financial world. The inevitable rise of the G20 over the G8, a natural consequence of the financial turmoil, weakens the UK's wider political and economic influence and thus its ability to bring in the profits our standard of living depends on. Borrowing is maintaining these standards but at the cost of weakening the UK's standing in the rest of the world. Eventually that will come home to roost. Without the finance to go out and be capitalists the UK will be relegated to the second division unable to compete with the likes of China's purchasing power when it comes to buying necessary resources.

There is no choice but to make the cuts in government spending, it is inevitable, and it is going to hurt. There will be a contraction of the economy with a reduction in the standards in living through lower incomes and higher unemployment, even cuts in benefits and service such as the NHS as the government tries to balance the books. If it does not balance the books, then the investors will pull out altogether and that will be a lot worse. The government cannot default on its debt as that will cause a panic in the market and make it impossible altogether to raise any of the money it needs to survive. Unfortunately, there is little realisation of how dependent we are on the foreign money markets.

We cannot rely purely on raising manufacturing output or deeper structural adjustments in the economy as this dependent on too many factors outside the Governments control. And there is still the question of our access to resources. The chances are the pound is going to remain weak, causing us to pay more to buy in the oil and iron ore – in turn dissuading further foreign invest, when it can be done cheaper elsewhere.

What does this mean on the streets?

We think it will lead to political unrest as much of what we have taken for granted is under threat. Even as activists we in the UK have been very sheltered from the rest of the issues facing the global economy. We have a welfare state that was founded on promises of income from a rich economy sustained by its place as one of the leading countries of the industrialised west. This gave the UK the power and wealth to continue to exploit long after its own resources had peaked.

The lessons of the 1970s have been mostly forgotten; a large chunk of those of us active today were only born in that decade. Since then we have lived through a society changed by Thatcher and Blair to one of selfish individualism, filled with expectation as to what is supposedly rightfully ours. Those "rights" to cheap holidays and all sorts of food when we want it came with a price paid by others. We are not as a nation in much position to continue with the sort of extortion that funded it. Certainly not now with China, India and the rest of the world far more able to compete for those same resources than we can.

As a society we have changed to one much less unionised and less unity, while having been encourage to have ever higher expectations. Governments can promise much but their ability to deliver is ever more reduced.

There is the very real threat of high inflation, which we believe is the most likely long term effect of the financial crisis and the one which will affect the average worker the most. High inflation (or even hyperinflation) takes money out of peoples pockets and threaten their mortgages and jobs. It wipes out people's savings and reduce the value of investments. There will be no scope for public sector pay rises to match this, resulting in a reduction in the standard of living, curbs on employment rights, and a long recession.

This and other factors laid out above we think set the course for a prolonged period where the country as a whole becomes poorer, and many more people experience precarity in their lives as the standards of living and average income drop, and the threat of unemployment becomes stronger.

As ever it is going to be the lower skilled workers and those dependant on the welfare state that will be first on the receiving end of the cuts the Government is going to be forced to make. A new generation is finding it increasingly hard to get jobs but already laden with debt from university, and simply not able to get on the housing ladder.

Many of the current strikes have their roots in the economic changes being wrought by the financial crisis. Cash strapped local authorities are going to be forced to cut back; the likes of the NHS are going to have to turn more and more to private sources of funding to continue to pay its staff. It is naivety to simply demand more money from government. Too often society focuses on relatively minor expenditures in the grand scheme of things, such as MP's expenses, but ignore the major financial shifts behind the scenes.

Though the bosses remain the problem, strikes alone are not going to allow us to maintain the standards of living demanded, not when the money to fund it does not exist in the first place

The UK is not ready for the shock of the transition to being no longer one of the globes most affluent countries, and the Government is failing to prepare for the nation for the inevitable. If there was just the financial crisis to worry about this could be done over decades. Climate change and peak oil / resources are going to accelerate the process, and that is not being budgeted for.

A key questions is whether the decline is going to be sharp and fast, or slow and drawn out. A shocked public is open to all sorts of suggestions, but if we are not ready to confront right wing or authoritarian left propaganda then we will lose the opportunity to make more fundamental changes to the system, to show that the grassroots really can provided the way forward. First and foremost, we need to be wary of the growth in power of the reactionary right who will seek to scapegoat minorities for these problems. Economic turmoil is the ideal breeding ground for them.

At the same time we have to manage expectations. The Left continues in its belief that all can be restored, that the same standards of living can be enjoyed by all under a socialist government. Sadly to say, the biggest and most damning effects of the financial crisis is going to strip away the illusions of self-sustainability that we have about our society and show that we are now even less capable of responding to the crises of resources – oil, water, minerals – and that of climate change.

There is also a danger that we allow the economic crisis to take precedence over other issues, accelerating the exploitation of the planet to maintain the unsustainable standards of living. We cannot bury our heads and preach in favour of the workplace, when the workplace itself is increasingly unviable. Economics is underwritten by resources; capitalism by ever increasing exploitation of those resources. Socialism seeks to replace capitalism but it has few if any answers for the exploitation of resources when they become scarce. We can no longer depend of 19th Century thinkers as the economic world has moved on from the time of Marx and co.

We do not provide answers, but highlight how often the solutions proposed by the Left are mired in unseen assumptions. Hopefully we have exposed some assumptions so that more realistic solutions can be developed in their place. As painful as the economic crisis is going to be for Britain, it will also open up a space for us to advance ideas built around sustainability rather than exploitation – but only if we are prepared to seize the moment.

In Part 2 we examine the unacknowledged assumptions behind our concepts of how the UK functions in terms of infrastructure and how the changing world affects them. These combine with the financial crisis to affect responses to the challenges of climate change and resource scarcity which open up a whole new set of challenges.

Glossary

Speculative Bubble: when investors get over excited about a particular type of investment which promises great rewards (tulips, internet companies, house prices) and pump in so much money it expands the market like a bubble until it overextends itself and bursts.

South Sea Bubble: the original big speculative bubble based about a UK company trading with South America, which delivered huge losses to its investors rather than the great profits it promised.

Sub Prime: generally loans given to people with poor credit ratings, often with penalizing interest rates which do not come into place for several years; mostly used to classify mortgages.

Profit Margins: a measure of how profitable a business is; the ratio of profit to the cost of selling the product. Higher margins means more profit.

Neo-Liberalism: the politics of transferring as much as possible of public services into the private sector; the defining policies of global financial players such as the International Monetary Fund, World Bank, etc.

Leverage: using the promise of future profits to take out loans now so as to be able to fund even more business deals; also a measure of how much a firms' is dependent on debt for financing its business – lots of debt translates to being highly leveraged.

Shadow banking: that part of the financial world other than banks; involves the (mostly) unregulated movement of money around the globe, includes hedge funds, venture capitalists, pension funds, etc.

Hedge Funds & Venture Capitalists: financial firms involved in raising money so it can be invested as profitably as possible. Involved in every type of business deal imaginable.

Investment Bank: a bank that makes its money from investments and business deals rather than the more traditional savings and loans model

Pension Funds: the private & public companies which take the money being invested for your pensions and try to ensure that it keeps its value and there is a decent amount to provide for you on your retirement. They own about 1/3 of the stock market

BRIC Nations: Brazil, Russia, China & India – the leading players in the emerging countries; the new boys on the global economic bloc.

Base Rate: the interest rate set by a nation's central bank for the interest paid on government debt, but used as the basis on which the interest rates of many other types of loans are also set.

Inflation: The measure of how the cost of living has gone up from the same time the the previous year; deflation is when it is going down.

Gross Domestic Product: the amount of money a country makes in a year – a measure of how rich it is.

Capital: another word for actual money, not the notional figures recorded on a bank's balance sheet.

Resources

For an excellent introduction to the world of high finance check out Nicholas Hildyards' *Financial Bricolage* at http://www.thecornerhouse.org.uk/summary.shtml?x=562658

Or for how governments reacted to the crisis Paul Mason's *Meltdown.*

There are many useful websites out there on financial systems, but we liked, among others

http://tutor2u.net/economics/content/topics/fiscalpolicy/borrowing.htm
http://www.ukpublicspending.co.uk/

And don't forget to read the Financial Times, Wall Street Journal or the business pages of the likes of the Times and the Telegraph, the latter in particular, and we always enjoy the naked cynicism of the Alex cartoon. There is a lot to be learned from them, and you soon learn to see your way through the political dross to the stories underneath.

The real warning signs of coming change are rarely going to be plastered across the front pages until its too late. They are going to come on the middle pages, the information to be sifted out and added up. Strip out the ones with the obvious agenda and dig for the facts underneath.

When the credit rating's agencies threatened the UK's prize triple A rating, the papers were outraged at New Labour, etc, but the real story was why they were even considering such a drastic move. The trends are there to spot.

About Us

Dysophia is a new imprint for publishing pamphlets and zines exploring issues around green anarchist thought in a way that makes the issues accessible to everyone. We try to avoid dense theory, but give the knowledge to empower and make up your own minds.

For us green anarchism is a powerful tool for analysing much of the world around us, from interpersonal relationships to how we take on the big problems standing between us and our ideal society. We want to educate and encourage debate, to question everything then bring it together with solutions that take us forward. We are not interested in prolonged bickering over moot points, but celebrate our diversity and our common ambitions.

It is okay to challenge each other, it is okay to disagree. Knowledge does not have to be unified, but through honest and open discussion everyone can benefit and make up their own minds. Anarchism, innit.

We are always interested in feedback, suggestions of topics to cover or even ideas of articles you would like to write for us. We will try to respond to all emails, but we cannot promise, and as much as we like debate what we ideally want are direct responses we can put into future publications.

Currently available issues are
Green Anarchism: a political toolbox (Dysophia 0)
The Crisis of Crises Pt1: The Financial Crisis (CC1)
The Crisis of Crises Pt2: Peak Resources & Climate Change (CC2)

In preparation:
Polyamory: anarchist perspectives (Dysophia 1)
Poverty, Privilege and Immigration (Dysophia 2)

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No subscriptions or website, but may be someday. In the meantime find us at bookfairs, infoshops and the like.