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# Financial Capitalism and the Future

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Donald Trump's election victory can be seen as the culmination of a series of events, including the May 2016 presidential elections in the Philippines and the UK's June 2016 Brexit referendum. These events were revolts against the expanding gap between the rich and the poor, a trend that is continuing, as also indicated by the general election results in the United Kingdom.

These events also symbolize a necessity for the global economy: the need for a transition from financial capitalism to a manufacturing economy. The reason is very simple: the financial sector widens the gap between rich and poor, whereas manufacturing closes it.

The problematic shift from manufacturing to financial capitalism began when Asian countries, including Japan, were attacked by speculators in the late 1990s. This slowed growth which had largely come from manufacturing output, supported by direct investment from foreign companies seeking cheap labor. Political stability was the prerequisite for such investment, alongside the provision of economic infrastructure. The crisis in Asian countries, which had been the powerhouse of global growth, resulted in a slowdown in the global economy.

*The Wall Street bull.*

The 1999 repeal of the Glass-Steagall Act in the United States triggered high-risk financial dealings by investment banks by enabling them to use deposits collected through their commercial banking arms. Banks began to focus on high-risk 'financial engineering' like sub-prime loans, collateralized debt obligations (CDOs), structured investment vehicles (SIVs), and derivatives.

Erroneous economic policies dictated by leading international organizations like the IMF emphasized privatization and fiscal austerity, thus reducing the pace of infrastructure building. In the cases of Argentina and Russia, this destroyed the domestic economy.

Political stability is essential to the economic growth of emerging economies. A clear contrast between economic growth under conditions of political stability and instability can be observed in the difference between Russia's economy before Putin and after Putin. The contrast between China and Russia after 1989 is also a good example.

The dominance of the United States after the fall of Soviet Union helped the rise of neo-conservatism in the United States, as well as encouraging the Blair doctrine, advocating "regime change" in emerging countries and using words like "human rights" and "democracy" as slogans, with NGOs often used as vehicles to promote the cause. Intervention in the domestic policies of other countries has caused chaos in the Middle East and North Africa and several former Soviet countries.

China never suffered such intervention, welcoming foreign factories and infrastructure-build-

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*Reintroduction of the Glass-Steagall Act is urgently required.*

ing through low-interest loans from Japan in the 1990s. Domestic political stability assisted the policies enacted by Deng Xiaoping to liberalize China's economy.

Western economies, particularly their "real" economies, have not recovered from the shock of the Lehman collapse and the 2008 financial crisis. Bailing out banks without pursuing liability led to a moral hazard well-described by the phrase "privatize profits, nationalize loss, socialize risk." Despite the crisis, investment banks continued to operate various high-risk financial products. They attacked small European governments in 2010 when fiscal deficits were reported as the result of fiscal stimuli introduced in 2009. Consequently, many EU countries adopted fiscal austerity when in fact they needed fiscal stimulus.

In an today's environment where confidence in the financial system remains low, and private companies are hesitant to borrow money and invest, quantitative easing by central banks cannot stimulate the real economy. Quantitative easing creates excess liquidity, which has been used by investment banks to attack small European economies. The only sectors for which a flood of liquidity was a good thing were energy, IT, and derivatives. The huge leverage introduced by investment banks has brought about a world economy even more volatile than on the eve of the Lehman collapse.

The desperate situation of Deutsche Bank, which became a safe-haven for global derivative transactions before the crash, is the best example. The only option for a soft landing would be nationalization; otherwise, a contagion effect could drive an unprecedented scale of economic crisis, comparable to the Great Depression. In this context, the reintroduction of the Glass-Steagall Act is urgently required, in order to prevent investment banks from further large-scale risks and destroying the world economy.

In a situation of economic stagnation caused by financial crisis, the U.S. government must take the lead in stimulating the national economy because households and the corporate sector have to reduce their assets by repaying debt to banks. Fiscal stimulus, including the construction of economic infrastructure, is essential to stimulating real demand.

### The Trump Effect

The emergence of Trump is highly likely to strengthen the real demand of the world economy in the following ways:

- Fiscal stimulus in the United States;
- The possibility of Europe following suit and abandoning inappropriate fiscal austerity policies;
- The end of economic sanctions against Russia;
- Collaboration between the United States and Russia, furthering peace in the Middle East.

### Proposals for Global Economic Development

In short, what is economically necessary is a return to manufacturing and a return of commercial banking.

The gap between current living standards and ideal living standards exists to a greater extent in emerging economies, being relatively small or non-existent in advanced economies, but targeting a rise in ideal standards in advanced economies could be crucial for stimulating global demand.

The Twentieth Century saw the creation of numerous world-changing innovations. The Twenty-first Century has created no products comparable to inventions like the airplane. Innovations of this kind would have a significant impact on the global economy.

Xinhua

*China's young labor force today: college students wait at the entrance for a job fair at the gymnasium of Tianjin University in Tianjin, north China.*

## The Chinese Model

China can be a model of economic growth for other emerging countries in the early stages of growth when the benefits of cheap labor can be leveraged. Infrastructure-building and political stability can induce foreign companies to build factories that take advantage of this cheap labor.

Whether such foreign investment targets the domestic markets of emerging economies or export markets would depend upon the size of the domestic market. Japanese companies have invested in Thailand mainly in order to export abroad, while their investment in Indonesia mainly targets the domestic market.

Beginning as an export-oriented economy and learning much from foreign investors, China is now transitioning towards domestic consumption, thanks to its huge domestic market. This may not be possible for other countries, which require strategies appropriate to their comparative strengths and weaknesses.

Although China is not facing short-term economic risk, the long-term could be different. From an economic point of view, the largest challenge will be whether it can reform inefficient state-owned enterprises. Other challenges include a democratic transition for domestic politics. By 2025, it is expected that:

• China's marginal rate of return on investment, which is declining every year, will have reached Japan's level;

• China's young labor force will have begun to shrink;

• Those born under the one-child policy will have become leaders in society;

• Political leaders who lived through the Cultural Revolution will have retired from the political scene.

## Inequality

Several fiscal measures can reduce inequality. A progressive income tax rate and the existence of an inheritance tax are good examples. The main reason Japan is regarded as one of the most "socialist" countries is that of its progressive income tax rate and heavy inheritance tax. Many countries across Europe and South America would benefit from similar structural reforms.

A regional safety net in international financing would be a measure to protect developing countries against external risks, avoiding a repeat of the late 1990s' Asian crisis. For example, the establishment of the Chiang Mai swap agreements network among Asian countries emerged from Asian economies' tough experience in the late 1990s.

Affordable education for everybody is the basis for an equal society. Governments should ensure all children have access to primary education and that equal opportunities are applied to higher education.