Neo-Liberalism, Global Financial Crisis and Lessons for Nepal

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1. General Background

The global financial and economic crisis that began in October 2008 from the US, the epicentre of the global capitalism, was the biggest in its magnitude and dimension after the Great Depression of 1929. By sensing the deeper crisis, it was asserted by none other than The Economist, a champion of capitalism that the capitalism is at bay (The Economist, 2008). There were major jolts to the neo-liberalism led economic policies under which the global capitalism was thriving for some time. Along with the deepening crisis globally, its basic premises have been increasing challenged (Stiglitz, 2008, 2010 and Tandon, 2008) with simultaneous attempts at reviving the state led Keynesian aggregate management economic principles. Parallel arguments have also been forcefully advanced based on various episodes of the history that perpetuation of crisis in the capitalism is inevitable due to inherent contradictions in the system (Bello, 2008, Beams, 2008, North, 2009, Plant, 2009, Foster and Magdoff, 2010 and Pollin, 2010). Amidst various arguments and counter arguments, a recovery of the global economy began in the late 2009 and early 2010 as a result of state led massive fiscal stimulus and bank bail out plans. The latest estimates have now confirmed that the world output decelerated by 0.6 percent in 2009 accompanied by as much as 3.2 percent downfall in the growth rate in the advanced capitalist countries (IMF b, 2010). The same forecasts show that in this year 2010 the output of the global economy will rise at a rate of 4.8 percent with 2.7 percent growth in the advanced capitalist countries[2] and 9.4 percent growth in the developing Asia. However, based on the more recent trends, the IMF and many others have warned that the recovery in the capitalist countries is very fragile and hence there is a big down side risk.

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[2] The forecasts made by other agencies are at the lower side. For instance, UNDSE predicts that the global out put will rise by only 3.6 percent in 2010 and 3.1 percent in 2011 (Vos, 2010). Interestingly, the same forecasts show that the contribution of developed capitalist countries now has reduced to 42 to 43 percent.

There are strong apprehensions on the sustainable recovery or easing out of recessionary trends on a number of convincing grounds. First, the recovery has been primarily due to excessive fiscal stimulus packages, restocking of inventories and bail out plans (IMF a, 2009 and Vos, 2009). Second, vulnerabilities in the financial market are still very high due to persistence of systemic risk in the financial system. Third, mammoth fiscal stimulus packages funded primarily through fiscal deficits have augmented public debts of many countries beyond limits with a fear of another crisis emanating from the likely debt default problem similar to the one faced by Greece and other some peripheral Euro Zone countries. The way the austerity measures have been introduced by cutting welfare benefits including jobs, pension schemes etc has increased the possibilities of generating another route of global recession with likely intensification in social contradiction and conflict. Fourth, the recovery is highly unbalanced; fast growth in some emerging economies having a tendency of another bubbles and overheating, low growth in the least developed countries and almost stagnating trend in the Western European economies. Moreover, the unilateral move by the US to adopt quantitative easing type monetary policy coupled with deliberate attempt at depreciating dollar for overcoming from the huge trade imbalances and other deep rooted economic problems is generating very adverse effect on emerging as well as other western capitalist countries with a fear of replicating of similar policies. There is also a tendency of increased protectionism. Above all, the recovery has been jobless in its nature without ease on worker's layoff and very high unemployment[3]. The unemployment rate in the developed capitalist countries is in the neighborhood of 10 percent and above at present. Very recent global forecasts also reiterate that no significant changes in the pattern of jobless recovery have taken place (Vos, 2010 and UNDESA, 2010).

Amidst such trends at the global level, the Nepalese economy is passing through stagnation and crisis (Khanal, 2010). This is raising serious questions on the appropriateness and viability of the ongoing neo-liberalism led economic policy regime

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[3] For the reasoning on the similar lines see Vos (2009).

that Nepal vehemently pursued since more almost two decades. In these backgrounds, in the paper below, main features of the neo-liberalism led policies dictating the global economic regime[4] is discussed in the beginning. While doing so, a critical assessment on the conditions under which the neo-liberalism led globalization policies were converted into financialilization has been made following the political economy approach that ultimately generated a bigger crisis abruptly in October 2008. The measures taken to revive the economies and inherent contradictions preventing the sustainability of economic recoveries is presented in the next section. This is followed by a brief discussion on the nature of the Nepalese economy and underlying reasons for a bigger threat of deep rooted serious crisis. The paper is concluded by deriving some of the important lessons that Nepal must learn from the neo-liberalism led global financial crisis for ensuring equity based self-reliant sustainable development.

2. Neo-liberalism and Global Financial Crisis: Features and Underlying Reasons

Getting prices right by eliminating exchange and price controls are the major ingredients of the neo-classical theory under which the most important premises of the neo-liberalism[5] are based. It argues that only a principle of getting the prices right through the interplay of market forces freely can ensure allocative efficiency of the resources, to be a precondition for higher productivity and growth. On these grounds, market and the private sector are regarded to be indispensable and the role of the state is downplayed.

One of the virtues of it is that it assumes institutions, both economic and political, as given and hence it does not foresee any obstruction by the given political and economic institutions in the outcomes of the policies. From the same token, both historical and contemporary societal factors perpetuating the underdevelopment are overlooked on

[4] The global economic regime should be understood as a system dictated by the global capitalist system under the leadership of the world super power i.e. US.

[55] The neo-liberalism is all for allowing the free market to rip but the difference is that it unlike the classical premises does not hesitate to embrace government bailouts when the inevitable financial crisis emerge.

the assumption that consideration of the technical factors are sufficient in the efficient working of an economy[6].

It is worth noting that in our societies the interplay of political, economic, and socio-cultural factors shapes the institutions which in turn influences policy decisions that determine benefits or opportunities to various section of society. The predominant political and social structure leads to aggravate discriminations in economic opportunities which reinforce unequal political power. The unequal distribution of power between the rich and the poor— between dominant and subordinate groups— helps the rich maintain or enhance control over resources. Unequal distributions of control over resources and political influence perpetuate institutions to protect the interests of the most powerful to the detriment of economic rights of downtrodden. Many studies even based on capitalistic premises indicate that inequality perpetuated due to political, economic, social or cultural discriminations affect the aggregate dynamics of growth and development[7]. This simply means that the neo-liberal policies ignore the power and social relations which are instrumental to the deprivation and underdevelopment in countries like Nepal[8].

On the other hand, one of the important ingredients of the neo-liberalism led policies is that for its working certain conditions like perfect competition and Pareto optimality are fulfilled. This means, for prefect competition, buyers and sellers should not be in a position to influence prices for which perfect information about alternatives should also be available. Similarly, complete freedom of entry and exit including the absence of scale economies, absence of product differentiation and complete mobility of resources is essential. More over, for Pareto optimality to exist, the conditions of perfect competition must be satisfied for all markets including factor markets. It is obvious that

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[6] For detailed discussion on the development of neo-liberalism see Killick (1989) and also see Levitt (2006) from developmental perspectives. For reasoning from the political economy and institutional perspectives on the weaknesses inherent in the neo-liberalism see Khan (2002), Khanal et al (2005) and Beams (2008).

[7] For some discussions on these lines see, among others, Bardhan (2000), UNDP (2002), Khan (2002), Rodrik (2004), Stewart (2004), OECD (2004) and Levitt (2006).

[8] In a recent book, Plant a distinguished political philosopher and a member of the British Parliament argues based on sound reasoning to the extent that how over time the liberal state sinks itself. See Plant (2009).

because of these abstract assumptions not working at the ground level, the Great Depression had to be faced by nations in 1929. There is no secret that it was because of state led fiscal policy measures advanced by Keynes in the form of aggregate demand management, western countries succeeded to overcome from the Great Depression. The Keynesianism predominated the shaping of economic policy regime up to the 1960s.

But the failure of the Keynesianism to tackle stagflation of the 1970s provided ground for the revival of the new classical principles based neo-liberalism within the orbit of global economic policy regime. Amidst high unemployment, Keynesianism proved incapable to cope with the inflation that became increasingly rapid during the 1970s. The accelerated inflation was associated with slow down in economic growth and actual increase in the trend growth of unemployment, a situation of stagflation. In a situation of breakdown of the Keynesianism, first monetarism followed by rational expectations hypothesis on the neo-classical lines were advanced to justify the role of the market. Theories of rent-seeking and directly unproductive profit seeking activities advanced additionally supported the view that government failure is more pervasive and apparent (Tullock, 1980 and Bhagbati, 1982).

As obvious, the stagflation leading to the decline in the rate of profit massively especially in US, at first, led to the collapsing of the Bretton Woods Agreement of 1944, which had ushered in the system of fixed currency exchange rates. In 1971, US backed down the Bretton Woods Agreement and announced a floating exchange rate system after two years in 1973. Amidst these developments, a big recession took place in 1974. As will be explained later, there is close connection between the frequent crisis in the global economy including the recent one coupled with big uncertainty and risk in the global economic system and introduction of flexible exchange rate system by the US which as well known is still an international currency despite unilateral decision to disobey the agreement of 1944.

Based on certain theoretical and empirical grounds, it was claimed at the time of stagflation that low growth and high inflation will not happen under neo-liberalism. That was a period when developing countries were also confronting with serious economic problems. Neo-liberal policies took the form of Reaganism and Thatcherism in the North and structural adjustment in the South. The policies of monetarism, deregulation, liberalization and privatization were first introduced in North followed by South although with some time intervals.

In the South, the World Bank and IMF forced developing countries to implement structural adjustment program. Such a program was introduced from the mid-1980s. In these economies, in the aftermath of oil crisis in the 1970s, there were the tendencies of rising debt, increasing inflationary pressures, BOP crisis and bourgeoning inefficiency and distortions in the public sector[9]. These adverse conditions were used to impose such a program with strong conditions of liberalizing the economy and down sizing the role of the states and the governments. Under this, loan receiver countries were compelled to introduce various market oriented reforms to initiate and enhance privatization, deregulation and liberalization policies without care on initial conditions and their ramifications. Apart from economic stabilization, it compelled program implementing countries to minimize the role of the state through abolishing subsidies, administered prices and government directed policies in various sectors of the economy. As an offshoot, IMF launched ESAF in the early 1990s after termination of the SAP. It had more draconian conditions. The topmost emphasis was given on economic stabilization by enforcing countries to implement tight fiscal and monetary policies. Expediting of deregulation, privatization and open up policies were part and parcel of the program. The Washington Consensus[10] jointly evolved by the World Bank and the

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[9] Unlike the generalized view, some qualification in this respect may be desirable. The inefficiencies and distortions were rampant in those economies where in the name of import substitution or protectionism reactionary governments were primarily engaged in institutionalizing the rent seeking practices.

[10] This has broad range of policies designed for developing countries to implement in a way that could ensure not only expedition of internal deregulation but also to see that open up policies are augmented through the means of competitive exchange rate, liberalization of inward foreign direct investment and property right policies. It stressed a so-called reform agenda which include i) fiscal discipline, ii) reorienting of public expenditure priorities, iii) tax reform, iv) liberalizing interest rates, v) a competitive exchange rate, vi) trade liberalization, vii) liberalization of inward foreign direct investment, viii) privatization, ix) deregulation, and x) property rights.

IMF in 1995 pushed liberalization and open up policies further. The establishment of WTO in the beginning of 1995 together with above programs enabled to make the globalization process almost complete. In a short period, most developing countries eliminated quantitative restrictions on imports, lowered tariff barriers, and reduced the dispersion of tariff rates (Rodrik 2004). It is interesting to note that the introduction of these programs almost coincided with the deepening or looming crisis in the capitalist economies as timing of introducing ESAF and Washington Consensus indicate.

Along with the implementation of these programs possessing stringent conditions, there was augmentation of both poverty and income concentration immensely through out the world. Widening of unprecedented gap between the have and have-not led to antagonize the toiling masses worldwide. Such a situation aroused after 1995 that the World Bank, IMF and the WTO could not conduct their annual meetings or conferences smoothly in designated places. In a situation of worldwide demonstrations quite frequently against multilateral institutions, the concept of Poverty Reduction Strategy Paper (PRSP) was evolved by the World Bank and the IMF in the late 1990s. Following an appeasement approach, the paper emphasized on country ownership and participatory processes resulting into preparations of PRSP by authorities in developing countries themselves. Under this, the World Bank and the IMF provided Poverty Reduction Support Credit (PRSC) and Poverty Reduction and Growth Facility (PRGF) loan respectively. The priority was given on poverty and related social development programs with equal emphasis on governance and institutional reforms. Despite claims of a significant departure from the past, an UNCTAD study by examining the macroeconomic and structural adjustment policy contents of PRSPs concludes that there is no fundamental departure from the kind of policy advice imposed under the “Washington Consensus” (UNCTAD, 2002). Findings of the study by Rodrik (2004) are most interesting and useful from developing country's perspectives. According to him, PRSP is simply an Augmented Washington

Consensus[11] with several additional layers of policy reforms, focusing heavily on institutional and governance areas. It is empirically at odds with the advanced countries' own historical development experience. It does not come with a well-defined list of priorities. Applied in practice, it is as likely to make things worse as to make them better (Rodrik, 2004).

As is well known, the capitalist society is marked by a profound contradiction between the material development of the productive forces, which it promotes, and the social relations within which this development takes place. The contradiction manifests when the rate of profit falls. It also triggers as a result of increased contradiction between the global forces under capitalism and the nation-state system in which the political power is grounded. Although integration of semi-capitalist, non-capitalist, or pre-capitalist countries and areas into the global market economy through neo-liberalism led structural adjustment and globalization opened new markets to overly produced goods and services, this was not sufficient especially in view of growing wealth and capital concentration amidst stagnating purchasing power of the masses. In the process, the capitalist economies faced overproduction of capital and under consumption of goods and services. According to one index, by 1997 the profits of US corporations stopped growing. The profit rate of the Fortune 500 went down from 7.15 percent in 1960-69 to 5.3 percent in 1980-90 to 2.29 percent in 1990-99 to 1.32 percent in 2000-2002 (Quoted in Bello, 2008).

It should be recalled that faced with a continued downturn in the rate of profit overtime in the real sector, US had undertaken a major restructuring program from the end of the 1970s itself. This involved the destruction of large swathes of manufacturing industry, the development of off-shoring and outsourcing to take advantage of cheaper sources of labor, and a turn to financial manipulation, such as hostile takeovers and mergers, as the source of profit. A closer analysis indicates that the transformation of the American

[11] Under the PRSP the ten conditions include 1) corporate governance, 2) anti-corruption , 3) flexible labor markets, 4) adherence to WTO disciplines, 5) adherence to international financial codes and standards, 6) prudent capital account opening, 7) non-intermediate exchange rate regimes, 8) independent central bank/inflation targeting, 9) social safety nets, and 10) targeted poverty reduction. No changes in the policies laid down in the Washington Consensus and simply addition of these led to term augmented Washington Consensus.

economy in the 1980s saw the emergence of a new mode of accumulation, in which profits were made through the appropriation, by financial methods, of already created wealth. As is well known, historically, wealth had been accumulated in the US economy through investment, trade and manufacturing. This means the transformation after 1970s was made possible through financialization amidst deindustrialization. Understandably, the driving force of accumulation became rising asset prices. By 1990s, a systemic attempt was made to create bubbles despite knowing that it could be a kind of short lived phenomenon. This was the only way to ensure profit to the corporate oligarchy and monopolists. The loose monetary policy of US under Alan Greenspan had encouraged technology-stock bubble in the late 1990s which collapsed in 2000 and 2001 leading to another recession.

Again with the collapse of technology bubble, attempts were made to counter a long recession by cutting the prime rate to a 45 year low of one percent in June 2003 and kept it there for over a year. This led to generate another bubble-in real estate. How such a course led to rapid increase in financialization can be understood by an example. In 1980, financial firms in US accounted for about 5 percent of total corporate profits. By 2006 this had risen to around 40 percent. On a global scale, financial assets in 1980 were roughly equal in value to world gross domestic product. Twenty-five years later they constituted 350 percent of global GDP (Beams, 2008).

Thus, the quest for higher profit was met through finanacilization of the global capital. With investment in industry and agriculture yielding either no or low profits owing, among others, to overcapacity, large amounts of surplus funds were circulated and invested and reinvested in the financial sector. The result was an increased bifurcation between a hyperactive financial economy and a stagnant real economy. The problem with investing in financial sector operations is that it is tantamount to squeezing value out of already created value. It may create profit but it doesn't create new value. Because profit is not based on value that is created, investment operations become very volatile and the prices of stocks etc can depart very radically from their real value. The phenomenal rise in asset prices far beyond any credible value fosters financial bubbles. The real estate led bubble had its roots on trillions of dubious transactions with big backlash and enormous devastating impact on the global financial system (Bello, 2008).

To be more specific, with very low interest rate, mortgage institutions encouraged mortgage holders to refinance their mortgages and withdraw their excess equity. They lowered their lending standards and introduced new products, such as adjustable mortgages (ARMs), ‘interest-only' mortgages, and promotional teaser rates. These served to reinforce speculation, and the rise in house prices made the owners feel rich; the result was a consumption boom in the US with very positive spill over effect on the global economy amidst export surge of many newly emerging economies. The mortgage-backed-securities which derived their value from mortgage payments and housing prices had enabled financial institutions and investors around the world to invest in the U.S. housing market. Most of the newly devised financail instruments used for extended or multiple transations were mostly unregulated[12]. In this way, the low interest rates leading to housing bubble amidst weak regulatory system were instrumental for the financial crisis which, in turn, was deliberately used to mitigate immediate crisis in the capitalism in the absence of other better policy routes at sight.

It is also worth noting that the big financial transaction in the present form, indeed, enhanced after the introduction of a floating dollar regime in 1973 after the collapse of dollar as an international reserve currency in 1971 as pointed out above. This led to begin instability in the trade, finance and payment system worldwide with encouragement to hoarding, manipulation and currency swaps for quick profits by the speculators. As a consequence, foreign exchange transaction in the world economy increased from $ 15 billion per day to $ 1.26 trillion by 1995. Today it has exceeded $ 1.9 trillion per day. The growth of derivatives was even more phenomenal. According to the Bank for International settlements, the value of the underlying asset on which the derivative is based for over the counter (OTC) contracts was $ 683.7 trillion at the end

[12] There is numerous body of literature on causes of financial crisis arguing on such lines. See Orlowski (2008) among others.

of June 2008. This is an amount equivalent to more than ten times world output. In parallel, a process of financialization and securitization magnified with very low sub-prime interest rate policy adopted to counter the recession of 2000 and 2001 as pointed out above. In 1995 the dollar value of asset backed security stood at $ 108 billion. In 2006 it reached $ 1.07 trillion (Beams, 2008 and Bello, 2008).

The growing competition and rivalry among the western capitalist countries coupled with emerging economic power of some of the developing countries challenging the supremacy of one dominant global economic power also contributed to generate the crisis. As noted above, the crisis also aggravates as a result of increased contradiction between the global forces under capitalism and the nation-state system in which the political power is grounded. Such a phenomenon has intensified especially after the global financial crisis. With deepening unemployment problem amidst fragile recovery in a situation of mammoth rise in trade imbalances, the US is trying to enhance competitive edge through cheap monetary policy which has encouraged dollar carry trade followed by appreciation of the currencies of many countries against dollar. This has increased antagonism within the capitalist countries with a fear of competitive devaluation of local currencies. It should be recalled that a similar tendency prevailed in the post 1929 Great Depression period which also contributed to the occurrence of the Second World War. More dangerous aspect of this is that the policy routes adopted by the US are quite similar to the routes adopted before the global financial crisis of 2008. This among others indicates the limits of the policy options which could ensure huge surplus value and appropriation of profits by the financial oligarchic under which the present financial capitalism is grounded. This also means that even in a globalized capitalist system, the rulers of the nation state are compelled to serve the interest of the nation's originated monopoly capitalists because the capturing of the state power very much depends on their backing or support.

In summary, the Wall Street meltdown stemmed ultimately from the crisis of overproduction of capital through various unfair means leading to worsening of crisis in the global capitalism. The financialization of investment activity so far used as a better root to cope with stagnation as well as an attractive mechanism to shore up profitability finally crumbled. It proved to be producing temporary prosperity for a few but ultimately ending up in corporate collapse and in recession in the real economy.

3. Rescue Packages, Revival and Sustainability of the Global Economy

Unlike during the period of Great Depression, some sort of prompt actions were carried out at country specific level, beginning from USA, the epicenter of the financial crisis. Similarly, some coordinated efforts were made at G20 and multilateral institutional levels. Despite differences on key issues due to the reasons stated above, the coordinated effort under G20 downplaying the role of UN including other sovereign nations is continuing.

Starting from the bail out plan to buy out of bank bad mortgaged-backed securities, simultaneous attempts were made at overcoming from the severe credit crunch problems that endangered not only the collapsing of banks and other financial institutions but also big companies in the real sector. Desperate attempts were made to shoring up confidence among the people, preventing the erosion of trust in the banks and other financial institutions and avoiding a massive bank run such as the one that triggered the Great Depression of 1929. Immediately after bail out plans, more comprehensive packages comprising of deposit guarantee, recapitalization of banks and new debt guarantee were formed and implemented. The notion of business to be untouched by the public sector was discarded and also the demarcation created since many years between the private and public sector were also almost blurred. Countries like USA adopted massive state intervention strategy in the Keynesian line and beyond and went to the extent of either buying equity shares of the banks or nationalizing them. In nutshell, three major programs in the form of fiscal stimulus, bail outs and easy monetary policy were carried out massively in US, Europe and many developing countries. For instance, fiscal stimulus packages introduced in the developed and developing countries were 3.7 and 4.7 percent of GDP respectively. By countries, it was 5.5 percent of GDP in US, 6.2 percent of GDP in China and 1.8 percent of GDP in India respectively (UNDPRC, 2009). Support to the financial system has been huge and enormous. Some estimates show that the financial resources injected into the global financial system was almost 25 percent of the global output with far more share in case of US and the UK. These were accompanied by very low interest rates. As a result of such steps and measures in a consolidated way, a recovery process in the global economy began in the late 2009 and early 2010 as stated above. But the irony is that the slow down in the growth rate reemerged in the capitalist countries with the beginning of the second half of 2010 itself. This has proven that the recovery is fragile and the uncertainty is hovering around. There is one important distinction. The economies of countries like China, India, Brazil and some others are performing well and are now considered to be locomotive to the global economy. Although the resilience of these economies during the crisis period and high growth rate thereafter reinforces such expectations, in the interdependent world amidst increased rivalry for protecting national interest, the likely problems to be faced by these countries in the event of continued stagnation and possible recession in the western capitalist countries can not be underestimated.

On the other hand, the closer examination of various factors in general and growth reviving factors in the US and other Western capitalist countries in particular reveals that the contributing factors are self contradicting and most fragile. This is the reason why there is a fear of reemergence of more devastating crisis any time in the future. There is added concern that growing instability in financial markets and the sovereign debt crisis in Europe may put global economic and jobs recovery at higher risks (ILO, 2010).

It is now more than obvious that the global recovery is primarily due to the mammoth fiscal stimulus packages and banking bailout plans. By now almost $ 1.4 trillion fiscal stimulus and about $ 8 trillion bank rescue packages have been injected worldwide. Out of that US, the epicenter of the crisis fueled major chunk into the financial system. One estimate shows that it diverted as much as $ 11 trillion public funds into the financial system. It has been estimated that nearly 63 percent (2.2 percent) of the 3.5 percent increase in GDP in the last quarter of 2009 was due to temporary government tax credits to consumers. It has also been revealed that Federal outlays added another

0.6 percent to growth. According to one estimate, cash for clunkers subsidy to car buyers alone contributed about 1.7 percentage points of the 3.5 percent growth. This simply means that if rescue packages were withdrawn instantly, the US economy would have again faced recessionary problems immediately[13].

The doubts on sustainable global recovery are now being corroborated by the deepening debt crisis that began in Greece followed by Portugal, Spain and Ireland. The debt crisis aggravated simply because the investors refused to buy government bonds. The investors feared of debt default by the government in a situation of unprecedented rise in the debt amidst continued shrink in the economy. This is still creating havoc in the world in general and Europe in particular despite rescue packages agreed for Greece by EU and the IMF which are in the threshold of similar crisis. The IMF forecasts show that by 2014, the ratio of debt to GDP in developed capitalists' countries will reach 115 percent. The debt to GDP ratio in the US has reached 87 percent in 2009 from 73 percent in 2008. It is projected that the ratio will surpass 100 percent by 2011.

In addition to big turmoil in stock markets continuously, the contagion type effect of the debt sovereign crisis was being experienced by many countries. As a result, not only fiscal stimulus has been withdrawn by all most all countries but also very strong fiscal consolidation policies by means of strong austerity measures have been pursued in tandem by them. This has increased confrontation between the governments and the working class. Why this is happening or manifesting? The crux of the problem with ongoing economic revival policies is that they are following the same path of economic bubbles as in the pre-financial crisis period although through different institutional means and tactics. The difference is that previously it was policy induced market led bubbles created by speculators in the property markets backed by banking oligarchy and stock market brokers. This time it is the state led bubbles depending on the excessive deficit financing and unsustainable debt. This distinction is often ignored by many by simply saying that now the role of the government has increased. The tactics

[13] Based on data released by the US Commerce Department time to time and information compiled from various websites furnished data on financial crisis related areas.

used is also not exactly the similar to the new Keynesianism. At the same time, the problem is not limited to the Keynesian aggregate demand management type as is argued by many simply ignoring systemic problems in the financial system compounded by deepening structural problems that are manifesting under the present global financial capitalism. Understandably, there is a need of deeper political economy consideration.

The trillions of money primarily mobilized through deficit financing were directed to give quick benefits to the banking oligarchic. Although this enabled to recover the economy at the aggravate level in many countries including US for the time being, the huge dividends and profits accumulated through bailouts were used as a means of fueling speculation on risky assets such as stocks, bonds, commodities and currencies. The dollar carry trade amidst deliberate dollar depreciation policy also encouraged such speculations[14].

Now in the capitalist countries to resolve the unprecedented debt crisis in the history, the routes of strong austerity measures are being implemented with tremendous social cost. The cuts in social contribution, reduction in wages and possibility of forced unemployment in large scale together with massive slash in government expenditure in social or welfare related expenditure indicates the mounting social conflict in the capitalist society in the days to come. The struggle launched by the working class of many countries indicates such a possibility. Additionally, how a balance between the further downswing in the economies as a result of big austerity measures and assurance of debt servicing is any body's guess. This again re-forces the fear of serious crisis in the capitalist economies in the days to come. As obvious in such likelihood, the developing countries will also be seriously affected as the dependency to or interdependency with the western capitalist countries indicates. It is noteworthy that despite increased contribution of emerging economies in the revival process, the projected contribution to the forecasted growth in the world output of the developed capitalist countries still stands at 42 to 46 percent (Vos, 2010).

[14] See The Economist and the Financial Times issues of recent months for details.

Another factor to be responsible to the likely crisis sooner than later is that despite dollar being instrumental for either contagion or deepening of the crisis, it continuously remains an international reserve currency. The continued very high trade deficit in US amidst very low interest rate accompanied by quantitative easing may be regarded to be some sort of zero sum game. This in addition to intensifying rivalry among nations as pointed out above due to creation of bubbles in many countries along with decline in export competitiveness; the inflationary pressures may gradually mount in the US. This, in turn, may, among others, erode trade competitiveness of the US with resurgence of trade deficit in an unmanageable way as in the past. In the event if interest rate becomes high then that will jeopardize the recovery process itself. The deliberate dollar depreciation policy if pursued for long that may also complicate recovery process. This also may motivate other countries to retaliate. This will be so by the major exporting countries which also hold dollar reserve in a big scale. More dangerously, in the present global system, unless there is sufficient dollar liquidity say through US trade deficit, there is no other sufficient means of meeting the dollar demand globally. Therefore, so long as dollar remains international currency, instability, unfairness and system of predominant global economic system along with the extent of taping of global resources freely will continue. This will continue and perpetuate a crisis prone system with very adverse effect on poor countries.

At the moment, the revival of the economies is not of the similar nature or dimension across the countries. Countries with internal aggregate demand induced market expansion led stimulus packages have not only been able to augment growth rate at a faster rate but also enhance the prospect of sustainable recovery in a relative sense. This is particularly true in case of countries like China whose industrial base is very strong facilitating higher employment as well. On the other hand, many developed capitalist countries provided especial benefits to the financial oligarchy and big businesses under the bail out or stimulus packages for ensuring higher profits to them. But in the absence of higher investment in real sectors as a part of the bail out or stimulus plan, no satisfactory progress could be made to resolve crisis in the labor market with doubts on the sustainable recovery. The course followed again is of the bubbles, similar to the pre-financial crisis period of 2008. This again reinforces the possibilities of deeper inherent contradictions in the system in the days to come. Many Western European countries are confronting with very low growth or stagnation in the economy due to persistence of structural problems despite bail outs. Although very recently a decision to phase out the stimulus package has been made due to public debt emerging a big problem, this has raised questions on the means and viability of recovery process as pointed out above. The most sufferers of the crisis are the poorest countries of the world as a result of vary fragile economic bases predominated by too much external dependency in the post liberalization period.

Above all, the most worrying phenomenon of the revival process is that it is a jobless recovery. Unless the purchasing power of the working class is simultaneously enhanced, the recovery can never be sustainable. There is a serious warning by the ILO on the same ground (ILO, 2010). Latest US official data show that despite some reversal in the decelerating trend in last few months, jobless rate is still in the neighborhood of 10 percent. The unemployment rate in some western capitalist countries is even higher. The rapid reduction in unemployment can not take place unless rapid restructuring of economies takes place that could help enhancing the growth of the real sector which is most challenging at the moment. The predominant influence of financial oligarchy in shaping the policy prevents this as the nature of rescue packages and the beneficiaries indicates. The jobless recovery is the outcome of this.

Although, boom and busts is the inherent feature of the capitalism, too much unsustainable means adopted for the recovery this time and their probable ramifications as pointed out above indicate that never such a down side risks was apparent at the time of recovery before, be it during the 1970s, 1980s as well as early 1990s and 21st century. New York University Professor Nouriel Roubini, who predicted the market crash of 2008, has again warned that easy money has created asset bubbles which may be planting the seeds of the next cycle of financial instability. The experience based on various turning points of the history shows that unless the systemic flaws of the global economic system perpetuated by the inherent contradiction in the capitalist system are corrected, a sustainable recovery will be only a wishful thinking.

Based on above discussions, following points can be highlighted:

- The fundamental notion of neo-liberalism that markets are self correcting, allocate resources efficiently and serve the public interest well is misleading and contradictory
- Over production of capital and under consumption of goods and services accentuated through too much concentration of wealth in few hands and stagnation or deceleration of purchasing capacity of the toiling masses under the neo-liberalism led global capitalism are bound to deepen crisis. Sudden fall in profit lead to generate and aggravate crisis.
- The financialization of investment at the cost of production sectors including deindustrialization as a better route to cope with stagnation or recession as well as an attractive mechanism to shore up profitability is contradictory and self defeating as the episode of financial crisis reveals.
- Too much deficit financing route to rescue or revive economies becomes not only unsustainable but also crisis prone as debt crisis in many countries and likely contagion indicates. This route becomes more questionable when it is used primarily to serve the interest of oligarchy and create another bubble. From the future world economic perspectives, this route could be most dangerous and devastating.
- Smooth functioning of global financial system can not go hand in hand with policy induced speculative business amidst very weak regulatory system. Tax heaven is one of the major sources of speculation and destabilization in the world financial system.
- Without job enhancing policy measures, sustainable recovery is impossible as augmentation of financialization led economic bubble becomes most unstable and shaky with formation of adverse expectations before full recovery begins.
- Neo-liberalism led policies in addition to encouraging similar economic character in South as in the North augment dependency too much and hence neo-

liberalism and self sustained development can not go hand in hand, necessitating policy alternatives.

- The financial crisis is systemic and hence it is impossible to sustain financialized capitalism with ever increase in asset value including value of stocks rather arbitrarily.
- The fairness and smooth functioning of the global economic system can not go hand in hand so long as dollar remains as an international reserve currency as it is not only perpetuating unethical speculative businesses but also making the world economy tied to the behavior of the US economy amidst excessive domination and control.
- There is a need of new global financial architecture by putting it within the UN system for enhancing fair global economic system in which the say of the developing countries is guaranteed. G20 is another form of domination and a deliberate attempt at escaping from the democratic UN system.

4. Nature of the Nepalese Economy and Deepening Crisis

The nature of the economy and its manifestation is partly reflected in the conditions under which Nepal was compelled to request the IMF for the Rapid Credit Facility (RCF). The IMF almost instantly approved the loan of US dollar 42.05 million as the press release of 28 May, 2010 indicates. It recognized that along with widening of current and capital account deficit, Nepal is in both foreign and financial risk. Although hidden conditions, if any, are not known, the IMF press release stated that at the core of the program are a tight monetary and fiscal policy stance to support the exchange rate peg, which remains Nepal's anchor for macroeconomic stability, and efforts to improve financial sector soundness (IMF c, 2010). This release is sufficient to understand the implicit conditions, i.e. Nepal must continue with peg exchange rate system and for that pursuance of more tight monetary and fiscal will be essential. At a time when Nepal is confronting with some sort of stagflation type crisis amidst limited internal policy space under neo-liberalism led policies, the ramifications of these conditions will be quite serious on the Nepalese economy. It is also worth noting that Nepal as a result of continued BOP problems is in the process of negotiating another RCF with the IMF.

If the history that led to begin the liberal policies is recalled, it resembles some sort of zero sum game. Twenty years back Nepal had requested the IMF for standby credit under economic stabilization program in a situation of foreign exchange crisis. In that many strong austerity related measures were conditioned. Since then, Nepal has implemented all multilateral led programs ranging from SAP, ESAF to PRSP. Nepal has also become the member of the WTO. The fulfillment of conditions has pushed Nepal into such a stage that Nepal now stands one of the most liberalized countries in the South Asian region. Both tariff rates and openness indicators corroborate this (Khanal, 2009).

But the nature and condition of the economy today clearly indicates that despite the growth in some sectors in the last two decades, Nepalese economy today is in the similar crisis as we experienced twenty five years back. There are serious problems in both external and domestic fronts of the economy which indicate on the possibilities of deeper crisis in the coming days. In the external front, the vulnerability of the economy has reached in its climax. The share of exports in 2009/10 has reduced to 16 percent from 26.7 percent just two years back i.e. 2007/08. With the deceleration in the growth of remittances inflow amidst decline in exports of goods and services, deficit in both current and capital account became a serious problem in some months of the last fiscal year. In the first two months of this fiscal year also, both current and capital accounts are in the red. This is happening despite remittances reaching 20 to 22 percent of GDP. Almost one third of Nepalese households somehow manage to get remittances for their livelihood and survival. Unlike in many countries, there has been no disruption in the inflow of foreign aid in the post financial crisis period too.

Along with the crisis in the external front more so in the aftermath of global financial crisis, the crisis in the domestic front has also aggravated. Amidst slow down in the growth of remittances inflow, the first casualty was the banking and financial sector. There was continued down turn in the banking deposits followed by the serious credit crunch problem in the middle of the last fiscal year leading to hike in the banking sector lending rate constantly. This persisted for long despite some policy measures pursued by the central bank. In addition to regulation in gold import, central bank imposed cap on the commercial banks in investing, among others, in the real estate and housing sector activities. This policy has been continued with decontrol of gold imports only recently after hiking of tariffs on imported gold. But more recent trends indicate that, despite all these and after some ease, the credit crunch problem has increased as interbank rate , among others, indicate. There are indications that these have had tremendous adverse effect on the ongoing economic activities. Many sectors including construction are continuously decelerating leading to contraction in the economy and dampening of income and employment opportunities. In deed, Nepal is now in such a trap type situation that on the one hand there is a need of augmenting economic activities for reversing declining growth trend and on the other there is a also a need of reduced investment in some sectors for coping with credit crunch problem amidst widening current account and balance of payment deficit. Even in a limited scale, given the size of the economy and the market, the phenomenon is almost the similar nature as happed in the capitalist countries during the financial crisis period. The widened mismatch or asymmetry between the production sectors and a few hyper unproductive sectors amidst flow of resources predominantly toward such sectors, the crisis of the above nature is manifesting. It is needless to point out that since the intensification of the liberalized economic regime, the production sectors have suffered much with share of manufacturing reducing to about 6 percent now. At the same time, with bubble type growth in some unproductive sectors amidst capital intensive nature of investment, there has also been deceleration in the domestic employment in tandem with majority of youths hunting for the foreign employment. By completely ignoring complex problems and ground realities of the Nepalese economy, very immature policies following the same neo-liberalism led financial capitalism principles are being replicated without attempts to create enabling investment environment in the productive areas. There is also added problem of capital outflow along with lending caps to the commercial banks.

Now on the similar neo-liberal policy grounds, more stringent conditions in the RCF of the IMF have been laid down. Completely ignoring as if the past policies were not instrumental for the present crisis, tight monetary and fiscal policies have been prescribed. As obvious, this will further limit the deficit financing at a time when the revenue collection is being hard hit by the new steps. There will also be further tightening of credit to the private sector by the banking and financial sector with additional contraction in the economic activities. This is a deflationary approach of rescuing an underdeveloped economy like ours from the likely foreign exchange crisis. It is worth noting that Nepal is one of the few countries which by following the donor's prescriptions, has always pursued tight fiscal and monetary policy by keeping budgetary deficits under limits coupled with some sort of monetary targeting. This means, the higher inflationary pressures that Nepal is experiencing since last almost there years would not have happened that too in a situation of deceleration in economic activities. The experience thus indicates that the panacea in the form of RCF and accompanying conditions will be more problematic in the Nepalese context. The contraction in production sectors including export promoting sectors will lead to exacerbate crisis in both external and internal fronts further with a danger of dept trap situation. It is difficult to understand that in what ground the pegged exchange rate system is being treated as an anchor of macroeconomic stability and financial sector soundness in Nepal despite dwindling of exports amidst worsening of export diversification and competitiveness under such an exchange rate regime.

Despite perpetuation in very low growth rate with wider fluctuations, deceleration in production sectors, unprecedented rise in income disparity and above all increased vulnerability among large section of population owing to lack of access to asset and or resources, employment opportunities and social security etc, we were continuously bolstering that Nepal has succeeded to maintain fiscal balance and economic stabilization prerequisites for enabling environment for investment, sustained growth and price stability. All these borrowed arguments relied on wrong premises without reference so Nepal's unique socio-conditions have proven to be hollow. The Nepalese situation corroborates the view that predominant emphasis on pro-cyclical policies ignoring structural problems led supply side and institutional bottlenecks is highly detrimental to the least developed countries like Nepal which is confronting with underdevelopment and deprivation of majority of the people. Now the time has come to identify the root causes of deepening crisis and evolve most credible and sustainable solutions. The changed political context followed by new commitments on changing economic course in conformity with transformational approach also demands this. It is needless to point out that if simply deregulation, privatization, liberalization and openness would have been instrumentals for Nepal's development, Nepal by this time could have been in the threshold of newly industrializing countries as Nepal stands one of the highly liberalized countries today.

4. Lessons to be learned by Nepal

The economic crisis is mounting in Nepal at a time when it is at the crossroad of major political changes in its history. After the success of historic people's movement of 2006 followed by comprehensive peace agreement with then CPN (Maoist), a genuine peace process has started in which some drastic reforms in political front are underway in a way to address structural conflict emanated from very discriminatory feudalism based political, economic and social structure. Inclusive development and socio-economic transformation are the buzzwords today. But the kind of economic policy regime is being continued or intensified is fully incompatible with inclusive and transformational approach of development. Moreover, the global financial crisis and its contagion additionally have proven that how the neo-liberalism led policy course could be harmful for countries like Nepal. Therefore, a necessity of evolving a new alternative development paradigm backed by an appropriate policy regime has arisen in order to ensure a self-sustained equitable growth and development.

The foremost lesson provided by the global financial crisis to the countries like Nepal is that there is a need of paradigm shift from neo-liberalism led crisis prone wealth concentrating and stagnating or decelerating purchasing capacity of the downtrodden to more balanced domestic led more equitable self-sustained growth and development. As is well known, so called export orientation amidst very low tariff rates in a situation of many additional domestic constraints can not make even the limited exports sustainable and facilitate broad based growth essential for a country like Nepal. This by very combinations of policies encourages imports leading to marked increase in external dependency of the economy as is happening in Nepal.

From the political economy perspectives, it is also well known that it facilitates urban based limited business class incentives to engage in multiple businesses leading to strengthening of a phenomenon of rapid capital or wealth concentration process overtime. The investment in unproductive real estate and other related activities augments that process further. In the process, it also through a nexus with urban centered business class facilitates ruling elites to accumulate wealth. Such a built in system enhances support bases among the ruling elites even if the course is harmful from the broader long term perspectives of the economy. At the same time, the major benefits to the externals are quite understandable. Such an economic course by its virtue steadily wipes out the genuine industrial class with hard hit on indigenous small and medium entrepreneurs. All in all, the neo-liberalism led policy regime by promoting casino type economy gradually dwindle the productive economic bases created with strengthening of boom and bust type economic phenomenon like in developed capitalist countries, very harmful to the country which is in an infant stage of development. The experience at the practical level proves that embedded adverse institutional and structural conditions additionally prevent so called trickle downing of benefits.

Therefore, there is urgency of alternative development paradigm which facilitates internal market expansion and augmentation by means of enhancing the purchasing capacity of the masses. This will require massive drive on infrastructure development, extensive use of domestic resources and employment centric policies and programs. As obvious this will demand highest priority on the production sectors like agriculture and industry with focus on the commercialization of agriculture and development of agro-based and other small and medium enterprises in tandem in order to promote equitable pro-poor growth and sustainable development. When pro-poor growth is stressed, unlike the customary, it must ensure that the income earning opportunities of the poor should be faster than the wealthy and higher income bracket.

The time has come to reemphasize on the agriculture development led industrialization of course, unlike the past, in a more balanced way. A comprehensive agrarian reform making land reform as a part and parcel of overall reform will be prerequisite. Unless institutional and structural problems in the agrarian economy are resolved opposite to the neo-classical lines, it will be impossible to enhance sustainable broad based agricultural development genuinely and ensure food security which is becoming a serious problem in Nepal.

While emphasizing on agriculture led industrialization, some cautions are necessary. It is not as if a protective economic regime like the one practiced during the 1960s and 1970s by many countries including Nepal could be replicated. In the globalized world neither this is possible nor sustainable. But taking competitive advantages into account, incentive structures must be built for industries with attempts at drastic reduction in both production and transaction cost. Various studies indicate that effective policy coordination is prerequisite for creating enabling environment. One distinction to be clearly established is that when rapid industrialization is argued, it is not like a byproduct of trade or mercantilism type policies as has been the case under the neo-liberalism led economic regime. Many independent studies examining causality of direction indicate on such a sequential necessity[15]. It should be backed by ambitious infrastructure development program, commercialization of agriculture and enlargement in the world class human resources supplemented by creation of special markets in semi-urban and rural areas. Creation of industrial, trade and other services hubs in semi-urban and rural areas aimed at promoting backward and forward linkages should be part and parcel of the industrialization drive. This will help to unleash of resources at the local level which is essential under the proposed new federal structure as well. The approach eventually would be of localization rather than homogenization without reference to local conditions and viability. It is instructive to remember that no country developed or transformed without feudalism abolition led agrarian reform and industrialization. The broad strategy

[15] A study in the Nepalese context also corroborates this. See Khanal and Shreshtha (2008).

should be the same but albeit with different approach and tactics in the changed context. This is the lesson given by the neo-liberalism led global financial crisis.

All these will require redefinition on the role of the state and the market with clear cut distinction between the catalyst and complementary role of the state and the private sector in important sectors of the economy. There is confusion perhaps based on the past experience when the role of the state is highlighted. The state's role should not be perceived today in a way that was carried out during the protective regime in which the tools were used to strengthen rent seeking society leading to inefficiency, mismanagement, scarce resource drain and retardation of development in a broad sense. The protective economic regime was simply used by bourgeois and reactionary governments for rent seeking purposes. There is a need of strong governance along with strengthening of genuine democratic system in which the state works both as a catalyst and facilitator toward the drive for, for instance, industrialization. Similarly, the private sector also can not be assumed to be homogeneous in character from the standpoint of genuine entrepreneurship. There is also a danger of elimination of small and medium enterprises unless especial incentives are provided. The role of cooperatives also can not be underestimated. The history of East Asian countries which is distorted today also clearly indicates that the state was catalyst to promote private sector led industrialization. The kind of competition is there today was not the same at that time. Additionally, the political conditions provided additional leeway in terms of external market to some of these countries at that time. Nonetheless, it should not be forgotten that cooperatives played a big role in the drive toward relatively more equitable development in these countries. It is needless to point out that to the extent the purchasing power of the masses is augmented that helps to augment self-sustained development.

As a part of this, complete restructuring of the government expenditure program is essential with focus on strengthening of bottom up budgetary process by ensuring transparency, accountability and people’s democratic ownership. This may also enable to assert on domestic ownership of external aid through a built in system. Unless the present system of resource drain, misuse and excessive corruption practices is checked as a part of policy reforms, drive toward productive investment will be impossible. In the course, sectoral prioritization will be essential under which the role of the state, private sector and the cooperative could be clearly delineated. At the same time, it will also be necessary to chalk out that how Nepal's present and potential competitive advantages could be tapped for bringing prosperity of the nation and the people within possible quickest time. A plan of drive to resource mobilization and higher saving will be equally essential followed by a better strategy of channelization them into the desired areas and sectors which could enable to reduce external dependency considerably within a short span of time. Perhaps there may not be dispute in saying that Nepal is a country with tremendous economic potentials which is hardly found in today's other least developed countries.

On the whole, there is a need of overhauling of more than two decades neo-liberalism led economic policy regime in which it is grounded and now, as obvious, broadly follows a financial capitalism led economic path. It is utmost necessary to ensure that new production and social relations are formed that could enhance the development of productive forces leading to changes in predominant economic and social structure. It should be recognized that the market in stead of modifying the existing social structure contributes to aggravate inequality in income distribution, access to assets and new opportunities as experience evidently proves. It is clear that unlike the catchy words of equitable development used following status quo approach; a new equity based development course will depend on the extent of attempts at bringing changes in policies and institutional structures that could contribute to create new production and social relations as these are influenced by the social structure within which the production process unfolds. Precisely saying, there is a need of compatibility between the new inclusive political structure that we are pursuing and the new economic policy regime that we need to envisage.

From the immediate standpoint of preventing further deepening of economic crisis, there is a need of fiscal stimulus packages accompanied by a program that ensures diversion of banking and financial institutions lending toward productive areas for reviving the economy and contributing to a new economic base in the line highlighted above. The package should focus on employment centric infrastructure and poverty reducing programs. But in the course care has to be given that price control and supply of essential commodities at fair prices are ensured. The central bank caps on commercial banks in investing in the real estate sector are premature because such steps have been taken without creating enabling investment environment in the other sectors. Creation of enabling environment with additional incentives to the small enterprises accompanied by building of confidence of the people in the banking system is essential.

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