Lessons never learnt

If there is one word that could sum up why the world economy is in such a mess, that word is "greed". From time immemorial, the humans have craved to live beyond their means if they can, and strive to get what they want no matter what, some by hook and others by crook.

The inability to controls one's own wants lies at the root of the problem of consumer excesses. Human wants, if left unchecked, become insatiable. Consumer satisfaction is no more than fleeting, with more wants cropping up all the time, demanding something bigger or better than what is already in one's possession. What's more, it's all wanted today and not tomorrow.

Economics recognizes that human wants have no limits, while resources do. It follows that consumers will have to choose whatever that come in reach, based on their incomes and preferences or priorities, with prices playing a market-clearing role, thereby equating supply with demand.

In other words, theoretically, human wants can be kept in check by incomes and the price mechanism.

The real world is not that simple. In a market-driven capitalist economy, instruments are aplenty to enable consumers to whet their appetites sooner by stretching affordability far above their current incomes.

Consumers do not have to accumulate enough savings before they can buy a car or a house, for they can get them all on hire purchase right away, as lending institutions accept these as collateral.

Thus, current income does not constrain current consumption, as the system allows consumers to consume on anticipated future income.

The so-called "permanent income hypothesis", based on the present value of future incomes, fuels the human desire for excessive, not moderate, consumption. Economics textbooks tell us that the consumer is king in a market economy, where producer supply responds to consumer demand.

In the capitalist system, consumers are manipulated or even exploited by producers through advertisements and promotions into buying certain goods and services, with supply creating demand, and not the other way around.

It is little wonder that ad-spend the world over amounted to a whopping US$583 billion (RM2 trillion) in 2007. Easy payment schemes crafted by suppliers in collaboration with financiers pave the way for excessive consumption.

The fractional banking system and the fiduciary currency system permit excessive lending way beyond the imagination of the man in the street. In the process, debts are packaged and sold in different forms and shapes, including the securitisation of debt.

Thus, a dollar deposited by a saver in a financial institution can end up in loans leveraged 35 times.

What has all this to do with the ongoing global financial crisis? Everything! Financiers play a key role in this game of production and consumption, riding on human frivolity.

It is not just individuals who succumb to such temptations. Firms, conglomerates, financial institutions and even governments exhibit such traits, wanting to expand, grow and dominate, for it is after all humans who run these entities.

The United States is an interesting case in point, not only because it is the largest economy in the world and the textbook model of a capitalist system, but also because it is the epicenter of the ongoing global economic meltdown. The US economy is driven primarily by private consumption. US consumer expenditure acts as the engine of growth for not just the domestic economy but for the global economy as well, given the enormous outreach the US has through the extensive financial and trade networks it has forged with the rest of the world.

Export-dependent economies owe their prosperity in no small measure to US consumerism, as they can ride on the coattails of US consumers whose wants seem uncontrollable. The system allows them to translate their wants into demand by giving them fairly easy access to funds way beyond their current earnings.

In the US, national savings are generated mainly by the corporate sector, with households accounting for no more than a small proportion of the total. Living perpetually on extended credit line has become the way of life for average Americans.

They depend on credit for nearly everything, including cars, homes, consumer durables and even holidays. There was no problem with this as long as there were steady incomes to pay the monthly instalments with no major disturbance to the consumption pattern.

Mortgage has been a roaring business in all this, with banks willing to lend based on collateral. As demand rises on easy credit, the market value of mortgaged collateral increases sharply, encouraging the banks to lend even more on their strength. This goes on and on until property prices reached dizzy heights, resulting in payment defaults and bank failures. The sub-prime fiasco in the US that triggered the current crisis is a prime example.

The recent hike in the price of oil may have expedited the credit crunch in the US by disturbing the fragile equilibrium in the consumption pattern. Given that US cities are sprawling, cars are an absolute necessity, not a luxury, for many, and the rising prices of petrol has forced them to spend more on fuel and less on other items, such as debt servicing.

Debts thus represent the mother of all problems the world economy is facing today. And debt is generated largely by uncontrolled wants and excessive consumption, which can fuel current GDP (gross domestic product) growth, contributing inadvertently to the recurrent boom-bust cycles time and again.

Seen in these terms, moderation in consumption is the key to economic stability. Moderate consumer behaviour, free from all temptations (admittedly a heroic assumption, given the frivolity of human weaknesses) would ensure stable GDP growth, albeit at a slower pace.

It boils down to a trade-off between rapid growth with ups and downs or a slow but steady expansion.

Recessions come and go, booms bloom and wither, and history repeats itself, all because some lessons are never learnt.

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