End days

After weeks of watching his screen, Alex Denton asks: is this the end capitalism?

In his book, Ubiquity, Mark Buchanan puts forward the proposition that many complex systems - everything from the earth's crust and species' populations to financial markets and even history itself - exist in a critical state, and that catastrophic events will occur within them corresponding to strict 'power laws' which, whilst being almost impossible to predict, conform to patterns of probability. This is not chaos; no butterfly wings causing tornados here, but a system in which small events act as triggers for much larger events. The difference, Buchanan says, between chaos theory and the ubiquitous critical state, is that more often than not, a small event remains small, and does not trigger anything larger at all. The problem, he says, is knowing when and why, a small movement in the earth's crust will trigger an earthquake. Or a set of figures will cause the markets to crash.

In the past two months, high finance has jumped from the grubby inner business pages - their fonts small and pictured only with charts - to the front. Headlines have been screaming the death message of financial excess, now ruined: The end of the world is nigh, they say, and they might just have a point. GFI has spent October, glued to our collective screens as the numbers so violently oscillated. Up a little one day, down a lot more the next; you could hear gasps punctuating the rattling of keyboards as the latest numbers come in. Because it has not been solely the scale of the falls, it has been the levels of government interventions as well. The numbers are truly fantastic: in a heartbeat billions have been wiped from the values of shares, but trillions have been promised to prop the system up. Not since the great depression of the thirties have so many owed so much because of so few.

We have also spent the month trying to garner comment from financial institutions as to what has been going on. But the banks have remained tight lipped. We have heard more than once that comment will not be given locally, that statements will be made only at strategic, global level. The banks, it seems, are rattled, and are circling the wagons - waiting for the dust to settle perhaps, to see who amongst them is still standing. Those that would speak to us did so off the record under the condition of anonymity. Such is the fear within the industry that many were scared for their jobs and the possible ramifications of putting heads above the parapets, especially in the light of the new, far tougher regulation that everyone is convinced is now coming.

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What we have witnessed, as Buchannan would term it, is the transition from stability within the critical state to its rupturing. Indeed, we have heard from many insiders that all bets are off, and the certainties of the last ten years of economics are finished. In the future, insiders, pundits and consumers alike are saying, economics will look a very different place indeed.

In an almost heroic fashion, the reign of the Masters of the Universe has come to abrupt and messy end. This description, first used in Tom Wolfe's Bonfire of the Vanities has been variously applied to Wall Street's traders and London's commodity brokers: anyone who dealt in money. And in light of the recent crisis, the finger of blame is being pointed firmly in their direction. They stand accused of risking everything for the promise of fantastical returns; of manipulating the markets for their individual, short term gain to the determent of the bigger picture.

Iceland, a small chunk of rock in the North Atlantic is home to just 300,000 people and yet in 2007, according to the UN Development Index, it was 'the most developed country in the world;' the Organisation for Economic Cooperation and Development declared it, per capita, the fifth richest nation on earth. In the (brief) years of glory, Icelandic bankers and brokers took tremendous risks - to earn tremendous fortunes - and bought everything from London's iconic Hamleys to the retailer Saks Fifth Avenue. How did such a small country attain so much wealth an influence? And why now is the Icelandic prime minister on record as saying, "it is not wise for a small country to take a lead in international banking?"

Iceland is a special case: the Armageddon Scenario; literally a handful of its most daring bankers and businessmen borrowed in the region of ten times the countries total GDP, leverage debt against debt and borrowing more against its returns. That exposed, and in that deep, any fall is going to be spectacular. IMF intervention was inevitable for a country that risked not being able to feed or clothe itself. It is that serious.

But debt has become a way of life across the board. The much vaunted US bailout - the initial $700 billion dollars promised by the government, and not counting the more recent bailouts and capital investments and guarantees - took their total deficit over $US11 trillion, or about 80% of its total GDP. If the per capita GDP is $46,000 then every man women and child in the US owes nearly $37,000.

But a culture of debt has become common place. Driven by the dream of home ownership, the availability of cheap credit cards and loans have pushed levels of personal debt to their highest levels in history. In the UK, the average household debt is £59,350 (including mortgages), in the US, the total amount of personal debt, again including mortgages, is closer to their national deficit at US13.8 trillion.

These numbers are huge and represent the air in the bubble - now burst - but the roots of this crisis are deeper. "The current crisis can be traced back about ten years," one London based economist told us. But saying so is akin to asking 'how long is piece of string?' There really is no simple answer, and the more you keep pulling, the longer the string will get. The past decade has seen markets battered by the Asian crisis of '97, the dotcom crash of '99/2000 and 9/11. All of these events spooked markets, sending them lower and causing reverberations far beyond the market or sector in which they occurred. Bur some argue that the beginning of the turmoil was almost exactly 21 years ago, the 19th October 1987: Black Monday, when New York's stock exchange tell more than 22 per cent in a single day. Others claim that the credit crunch can be traced back further still, and is a result of the kind of 'voodoo economics' that Ronald Reagan and Margaret Thatcher were so fond of in the 80's - a deregulated market free-for-all where everything is for sale, irrespective of when or where: the birth of globalisation.

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Opinions differ as to the relative virtue of such historical histrionics, but most are in agreement that deregulation and globalisation have both played a significant part. The economic system has always been cyclical - there have

always been slumps and rallies, and crashes are not as uncommon as you might think. The difference is that "they are happening much faster now."

Global markets never close; as London is winding down, so New York is opening, with Hong Kong, Singapore and Beijing following on after that. Australia closes the loop and the whole cycle begins again. Linked by communications travelling at the speed of light, panic spreads around the world faster than the dawn. Good news travels just as swiftly, but bad news carries more weight along with it. Market liberalisation has led to mass deregulation - almost anything was permissible: credit debt swaps, huge derivative gambling and shorting are amongst the leading culprits - which has seen the gloves come off. Economics is harder now, as well as faster. Deals that would have been considered too risky to pursue twenty years ago were suddenly the stuff of huge industries. Hedge funds made staggering amounts of money by betting on market movements, both up and down, often without any human intervention.

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According to the UK's Guardian newspaper, so-called 'algotrades' - trades made according to complicated algorithms automatically by computers - "accounted for as much as 40% of all trades on the London Stock Exchange in 2006; on some American equity markets the figure can be as high as 80%." This automation has led to enormously complex trades becoming the norm: mere humans struggled to keep up. As Richard Dooling put in the New York Times: "the best and brightest geeks Wall Street firms could buy fed $1 trillion in subprime mortgage debt into their supercomputers, added some derivatives, massaged the arrangements with algorithms and - poof! - created $62 trillion in imaginary wealth."

So real debt was created from imaginary wealth, and it gets worse. The monies being generated on these complicated trades were in part formed from very real money indeed. More traditional fund managers, for example those that manage our pensions and savings, were seduced by the numbers being generated by hedge funds and computers. They transferred real assets, our savings and investments for the future, and they were swallowed up, lost in the bottomless pit of suddenly toxic debt.

This is why the governments stepped in; the market, held in a critical state for years finally collapsed. Initiated by a small event, the effects snowballed along the fissure lines toward catastrophe. In another year, subprime mortgages or electronic derivative selling might not - just as 9/11 or the dotcom disaster didn't - have caused this calamitous meltdown. But this year it did, and in doing so, it has revealed both the robustness and vulnerabilities of the system. Capitalism itself is a natural critical state; the system has survived, but its survival is dependent on an evolution, and this shift - just as an earthquake levels cities - has laid waste to the previous economic landscape. GFI