18

# COMPETITIVE BUSINESS STRATEGIES FOR SUSTAINABLE DEVELOPMENT

Ms. K. MALARVIZHI
Ms. L. ESTHER THAMARINE
Ms. R. ANURADHA
Mr. S. VENKATESAN

VOLUME I

# Competitive Business Strategies for Sustainable Development

Volume I


**EDITORS**

Ms.K.Malarvizhi

Ms.L.Esther Thamarine

Ms.R.Anuradha

Mr.S.Venkatesan

*DEPARTMENT OF BUSINESS STUDIES*

**HINDUSTAN COLLEGE OF ARTS & SCIENCE**

PADUR, KELAMBAKKAM, CHENNAI 603103

TAMIL NADU, INDIA

*Competitive Business Strategies for Sustainable Development*

1st Printing 2012



**ISBN** : 978-93-81208-11-3

**Editor Board**
Ms.S.Senthamiz Selvi
Ms.V.Komala
Ms.J.Jeya

Published by
**G.K.PUBLISHER (DAKSHIN)**
16, M.R.M. Road,
C.A.R. Complex, West Tambaram,
Chennai – 600 045, India. 94448 81098.
E-mail: bhaghavanpress@gmail.com

Printed at
**BHAGHAVAN PRINTERS**
E-mail: bhaghavanpress@gmail.com

# BANK FINANCING AND ECONOMIC STABILITY

**Dr. M Selvam Head,**
Bharathidasan University,
Tiruchirappalli

**Isaiah Onsarigo Miencha,** Research Schalor
Bharathidasan University,
Tiruchirappalli

## Introduction

The question being addressed by this paper concerns the proven weakness of the real sector of the economy to convulsions in the financial sector. While admitting that some adjustment to the present system might reduce the transmission of instability, the question considered is whether there is a role that non-bank socially oriented institutions can play in providing for the financing of the business sector of the economy.

The situation that interests this paper is the uncertainty and the dislocations that have taken place in the real economy in the light of the convulsions in the financial sector. The main hypothesis will be that credit has become the vulnerability link between the real economy and the financial markets. In order to understand how we got ourselves into the present situation it will be useful to consider those features which characterize the present system and to highlight the vulnerabilities which stand out. The main features of the system can be summarized in a list of propositions. We list them as follows:

1. Credit is the link between the real sector(production and consumption) and the financial sector of the economy
2. Credit is one of three ways of financing business operations (production and commerce). The other two ways are equity and retained earnings.
3. In recent times, partly because of the growth of financial innovation, credit has emerged as the dominant form of business financing.
4. Credit is also an important determinant of consumer spending plans and consumer confidence.
5. Credit institutions now make use of complex financial instruments which have significantly reduced transparency **(Mark Jickling, CRS Report for Congress, Containing Financial Crisis and November 2008).**
6. The extensive use of borrowed funds (leverage) allowed for credit exposure way beyond what was traditionally regarded as reasonable– potentially highly profitable, but also more risky **(Mark Jickling,** CRS Report for Congress, Containing Financial Crisis, November 2008).
7. An increased tendency to move risky financial speculation off the books so that results do not appear in the accounts of parent financial institutions - creative accounting **(Mark Jickling, CRS Report for Congress, Containing Financial Crisis and November 2008).**

The literature is now full of the exploits of longstanding and until then well respected financial institutions which have now folded because of behaviour which speaks to the prevalence of some of the features mentioned above. The names of institutions like Merrill Lynch and Bear Sterns or even more so, like Lehman Brothers have now become synonymous with traits like lack of transparency and creative accounting **(Mark Jickling, CRS Report for Congress, Containing Financial Crisis, November 2008).** So the features we have mentioned above are by no means anomalies. In the end the credit freeze which resulted when the chickens came home to roost, as it were caused severe dislocations both in employment and in the consumption spending causing untold hardship for huge numbers of people.

We present below a formal representation of some of the key features of the system.

## Modeling the System

In the system below the symbols have the following meanings;

Y, output; L, labour; K, capital; F, finance; CR, credit; EQ, equity;

RE, retained earnings; Con, consumption plans; FMA, financial market activity

$\pi$, profits; r, the average return from financial market activity

$\lambda$, the proportionality factor linking credit with aggregate finance

$\mu$, a measure of the unit cost of acquiring financial assets

$\tau$, a transparency indicator, $\acute{\alpha}$, a creative accounting factor

subscripts *bus* refers to *business,* and *act* to and *actual* values

The values of EQ, equity, RE, retained earnings and $\pi_{bus}$ are deemed to be exogenous.

$Y = Y(L(F), K(F))$ .....(1)

$F = CR + \overline{EQ} + \overline{RE}$ .....(2)

$CR = CR(\pi_{act}) = \lambda F, \ \lambda \rightarrow *$ .....(3)

$Con = C(CR, Y)$ .....(4)

$\pi_{act} = \overline{\pi_{bus}} + \pi_{FMA}$ .....(5)

$\pi_{FMA} = \tau^{-1} r^{\acute{\alpha}} FMA - \mu FMA, \ 0 < \tau \leq 1, \acute{\alpha} \geq 1$ ..... (6)

$\pi_{act} = \overline{\pi_{bus}} + \tau^{-1} r^{\acute{\alpha}} FMA - \mu FMA,$ .....(5a)

Since a value of $\acute{\alpha} = 1$ leaves the rate of return coefficient, **r**, unaffected, values of $\acute{\alpha} > 1$, can be interpreted as use of creative accounting, with $\acute{\alpha}$ effectively being an asset value inflation factor

$\tau \rightarrow 0$ reflects a departure from transparency and high degree of complexity in financial instruments which makes it difficult to put a value on them. This makes it possible for low value assets to be declared as having very high value. Declared financial market profits, $\pi_{FMA}$, might therefore be high, with actual profits, $\pi_{act}$, being low. By the same token $\tau = 1$ implies that there is no complexity preventing proper valuation of assets.

When $\acute{\alpha} = 1$ the accounts of the lending institution are a fair representation of performance, that is, there is no creative accounting. In this case too, the true rate of return, **r**, emerges unaffected. This means that with $\tau$ and $\acute{\alpha}$ both equal to 1, the profit expression in (6) simplifies to become

$\pi_{FMA} = rFMA - \mu FMA, = (r - \mu) FMA$ ..... (6a)

Where confidence begins to be lost, partly because of revelations about $\tau$ and $\acute{\alpha}$, what we would expect is that FMA will have reached a point where, because of the attendant risk-induced deterioration, the phantom profit quantity, $\pi_{FMA}$, will itself be sensed to be diverging more and more from actual profits, $\pi_{act}$ . Once the deviation becomes more revealed, the losses from falling financial market profits will exceed profits earned from business loans in absolute value and the overall profit position of the lending institution will become negative. It is this compromised position of the lending institutions which will trigger the credit crisis in the real sector of the economy. In the USA, for example, the data show that loans to commercial and industrial customers fell from $1,228 billion in 2007 to $507 billion in 2008, a collapse of almost 60 percent (Federal Reserve statistical release, March 17, 2009).

I have tried to capture most of the features of the system, as described, in the expressions above. Given this framework it is possible to highlight two things:

1) The vulnerability of the production system; and
2) The points of entry for a new system – changed values of key parameters, maybe.

**Profit making and bank behavior**

Let us recall the expression which describes the way banks derive profits from financial market activity. Equation 6 above was written as

$\pi_{FMA} = \tau^{-1} r^{\acute{\alpha}} FMA - \mu FMA, \ 0 < \tau \leq 1, \ \acute{\alpha} \geq 1$ (6)

For simplicity we can rewrite this as

$\pi_{FMA} = \rho FMA - \mu FMA,$ (6b)

where $\rho = \tau^{-1} r^{\acute{\alpha}}$ .

Since (6) is a profit expression the term, $\rho FMA$, can be interpreted as an earnings term, reflecting the interest earnings and sales of financial assets by the banks. The parameter, $\rho$, would capture the average declared return on all assets held, both those purchased and those packaged or "created" by the banks themselves.

Similarly the term, $\mu FMA$, can be taken to be an expenditure value reflecting the outlay by banks on the acquisition of financial assets. In this term the FMA would refer to assets purchased either for purposes of earning a return from holding them over time, or for purposes of resale to other players in the market. In a sense the $\mu FMA$ term is better written $\mu(FMA).FMA$ since the $\mu$ can be interpreted as a unit cost value which is (positively) linked to the volume of securities acquired.

With this in mind the profit expression can be rewritten as

$\pi_{FMA} = \rho FMA - \mu(FMA).FMA$

At the maximum profit level ($d\pi_{FMA} = 0$) we will therefore have

$d\pi_{FMA} / dFMA = \rho - \mu'(FMA).FMA - \mu = 0$

This gives the result

$FMA^* = (\rho - \mu)/ \mu' (FMA)$

In other words the profit-maximizing level of financial activity will depend on

i) the declared return on assets
ii) the unit cost of the assets being acquired and
iii) the rate at which the unit cost of assets changes (shape of the asset supply curve)

This would seem to be a reasonable result with the profit-maximizing level changing in the expected direction as any of the right-hand-side factors changes.

What is interesting about this result is that the factor, ρ, is not truly independent. It is certainly within the decision space of the banks! In fact it is like a rogue parameter which increases when transparency is given up and when creative accounting becomes the norm. It is in this context that the large literature linking the recent outcomes in the financial markets to **greed** may have to be taken seriously. Considerations about the ethical behavior of the lending institutions cannot, in these circumstances, be ignored.

Moreover, we know that

i) ρ depends on the true return on assets, r, the transparency parameter, τ , and the creative accounting parameter, ά, and that

ii) it is only lower levels of transparency and a greater use of creative accounting that will increase the size of ρ.

This means that if there is an increase in the unit cost of assets or a perception that the cost being paid is too high, instead of a decline in the profit maximizing level of asset holdings, ethical slippage on the part of lending institutions suggests that we are likely to see a resort to transparency and accounting devices, namely an adjustment in ρ. The need to maintain a desired difference between declared returns, as mirrored in ρ and the cost of participation in the market, as seen in μ, would mean that reduced transparency and reliance on creative accounting will become the norm (For those who think that this comment is unfair to the lending agencies reference can be made to the many commentators on this matter including Paul Krugman, Joseph Stiglitz, and of course, Warren Buffet.)

It is not difficult to show that genuine robustness of the system really depends on high values of τ and low values of ά. In other words, not surprisingly, stability in the system is linked to values of ρ that are closer to the actual rate of return, r. However, since, as we have seen, lower values of ρ would not be consistent with the impressive profits which some lending agencies have come to regard as almost an entitlement, the question that arises is whether the lending agencies, as presently configured and regulated, should be retained as part of a stable economic system. More precisely, the issue is whether the productive component of the economic system should not be shielded from the effects of the dubious profit-calculating behavior on the part of lending agencies. Put another way, protecting the productive sectors would seem to require

1. ring fencing the ethical proclivities of players in the market and
2. finding alternative sources of financing for productive enterprises.

**Exploring Financing Alternatives**

The present system of financing business enterprise essentially rests predominantly on two pillars – bank credit and profits. In the diagram below we represent these as a market pillar and a non-market pillar.

The diagram portrays the assumption that business finance which lubricates production is itself derived from market sources and non-market sources. The market sources provide equity and debt financing with sources being commercial banks, merchant banks and other finance companies. What is important here is the assumption that commercial and investment banking companies operate in the financial market as buyers and sellers of securities and that this financial market activity has become an important determinant of the profitability of these companies. This matters because we also assume that the credit capacity of the lending institutions depends on their overall profitability.

The *non-market* source portrayed is *retained earnings*. This comes, of course, out of profits made by commercial enterprises.

In a very broad sense it can be argued that, in the system as portrayed, production will ultimately depend, on the one hand, on the volume and value of the financial market activity taking place. On the other hand, to a more limited extent, the scale of production would be influenced by the quantum of retained earnings made available. What is interesting about this broad observation is the implicit, but very important, role of expectations. If, for whatever reason, there is a collapse of confidence in the financial markets there would be a strong possibility that because of the impact of the unavailability of finance, production would be severely compromised. Similarly, if consumer expectations have a direct impact on production this will cause firms' profits to fall thereby inducing a possible decline in retained earnings. This, in turn, will negatively affect production which will further cause economic activity levels to decline.

If the framework presented accurately portrays the system which links the production sector to the financial sector, the major concern will be with the sustainability of the production system in the face of possible convulsions in the financial sector. We would certainly want to be assured of the stability of the financing base of the production that sustains the economy. The main contention of this paper is that stability of the financing base of production will warrant:

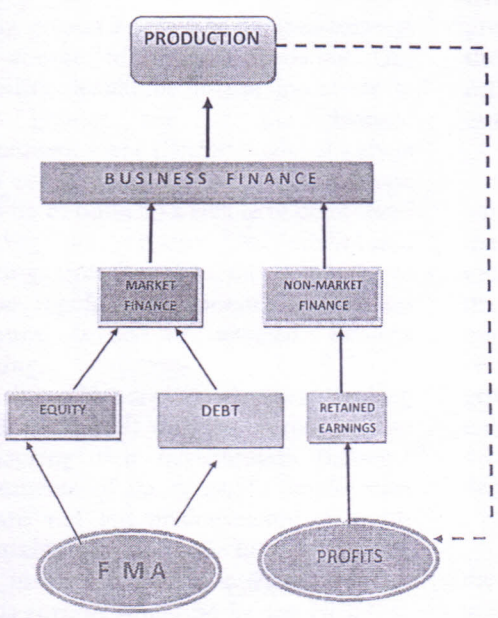
1. Introducing new options for business financing , and

2. Instituting a system to monitor and control the exposure of the business sector to players in the financial market.

The paper will focus on the first of these two requirements.

The point here is that what the recent events have shown us is that our prior confidence in markets to deal with conditions which threaten stability of the economy has been misplaced. According to **Stiglitz** the crisis was born of "a belief that markets are self-adjusting and that the role of government should be minimal". It is "this flawed economic philosophy which made it inevitable that we would eventually arrive at the place we are today". The colossal failure of the U.S. financial market to deal with stability threats which became visible at least two years before the 2008 debacle, and possibly as many as six years ago when a major player described derivatives as " financial weapons of mass destruction", is an overwhelming indictment of the market system. "The derivatives genie is now well out of the bottle, and these instruments will almost certainly multiply in variety and number until some event makes their toxicity clear. Central banks and governments have so far found no effective way to control, or even monitor, the risks posed by these contracts. In my view, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."

Fig. 1: BUSINESS FINANCE PILLARS




FINANCIAL MARKETS AND THE ECONOMY

| ITEM | WORLD MARKET VALUE (2007) |
|---|---|
| World Economy | $ 40 trillion |
| Bond Market | $ 45 trillion |
| Stock Market | $ 51 trillion |
| Derivatives Market | $ 480 trillion |
| Combined Financial Market | $ 600 trillion |

Source: Bank of International Settlements

Although the connection between the financial market and the economy is not always a direct one it is the relative size of the combined financial market, and the derivatives market, in particular, when compared to the economy, which raises concerns.

The diagram below portrays the two options now apparent. In diagram 2a we show the present situation with a dominance of the market pillar. From the diagram it is obvious that if this pillar collapses the non-market pillar will not be able to meet the financing requirements of the business community. In diagram 2b the roles are reversed. In a situation where we cannot rely on markets to bring about stability the case for moving to option 2b becomes a strong one.

What we have observed in the period September 2008 to present is a significant weakening of the market pillar. Suggested explanations range from the greed of key players in the market to the failure of the regulatory system to take corrective measures in a timely fashion. Whatever the reason, it soon became evident that the some banks in the system were not in a position to provide the financing needed by businesses to carry on their operations. In the USA, for example, business lending which stood at $177.2 billion in 2003 and increased to $1,228.4 billion in 2007 collapsed to $507.0 billion in 2008 (**FEDERAL RESERVE statistical release, March 17 2009**) For T&T although it was not realized such a dramatic decline, we observed a similar trend. For the share of business loans which stood at 9.6% in 2003 fell to 8.6% in 2007 (**ANNUAL ECONOMC SURVEY 2007, Central Bank of Trinidad and Tobago**). It is this possibility of a credit freeze which we should make every effort to avoid in the future. The impact on international trade, and in particular, trade which was the virtual lifeblood of some developing countries, is likely to have serious long term effects.

BUSINESS FINANCE OPTIONS

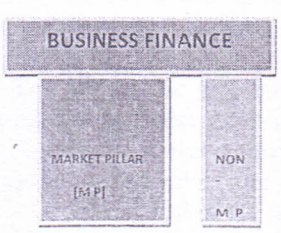



Fig: 2a

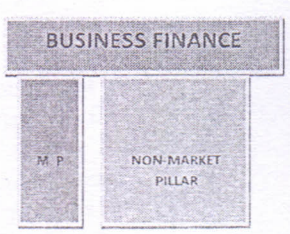



Fig: 2b

**Institutional Changes Needed**

If the stability of the production system is to be assured there would seem to be two institutional measures which need to be undertaken. **Douglas North (1995)** made the point that the role of institutions in our society is to reduce the uncertainty which is a normal (and sometimes a costly) feature of our everyday life.

With this in mind, the recommendations being made for regulatory tightening certainly make sense. There have been widespread calls for improving the capacity to monitor and regulate financial institutions making possible "more disclosure and reporting (1) from currently unregulated firms and sectors and (2) about off-the-books activities of regulated firms." [**Douglas North (1995)** pg. 22]

It must be kept in mind that the key players in the financial market have proven themselves to be very inspired human beings. This means that in most cases warranted regulatory adjustments will be a necessary but not a sufficient response.
In developing countries where the markets have not yet attained the degree of superiority witnessed in some of the developed countries, it might be wise to be proactive. The suggestion is that they substantially reduce the **bank-credit dependence** of the business sector by activating two alternative sources of business finance:

a) Placing greater reliance on retained-earnings as a source of business financing. One possibility would be to use incentives to make greater use of the dividend reinvestment plans (DRPS) model already in use in some countries. The aim in this case would be to build up a culture of debit-based financing as opposed to credit-based financing. Another possibility would be to use the regulatory framework itself to set minimum levels of retained earnings financing.
b) Instituting a National Development Banking Network (NDBN) with the express purpose of ensuring that the business financing requirements of the country's development plan are not left predominantly to profit-maximizing players in the financial market. As an institution created to ensure stability, one suggestion would be for the NDBN to be capitalized partly out of the government's revenues and partly by those social financing agencies that have a vested interest in keeping the rate of inflation low. These latter agencies include the Social Security System and the Trade Union Movement both of whom hold responsibility for significant pension funds, and the Credit Union Movement which is a major savings vehicle for large sections of the population.

The diagram below portrays the structure of the suggested new dispensation.

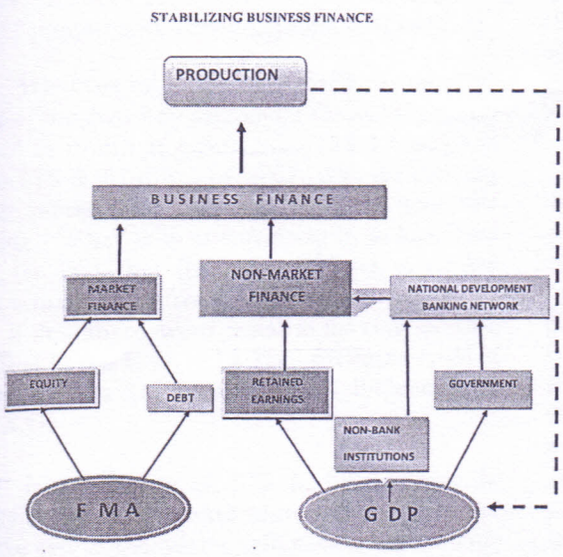
The modified system presented seeks to shift the reliance of the production system away from debt financing. The equity component of market financing can be strengthened by the more widespread use of dividend reinvestment plans (DRPs) whereby, in lieu of taking cash payments, dividend earners roll over their earnings into new equity (For more on DRPS see. In some countries where these plans exist taxes are still paid on these dividends. In the interest of motivating a shift in business culture one suggestion is for either full or partial removal of these taxes as an incentive to change the character of the financing base of the production system.

On the non-market side the diagram portrays a strengthened traditional component in retained earnings, as well as two new components. The new components are the non-bank savings institutions and the government. The importance of these players lies in the fact that the motivation for their financing outlays is not ***profit.*** In the case of agencies like the social security institutions, trade unions and the credit unions, one of the main motivations would be the need to keep production levels high as a means of controlling the rate of inflation. As institutions with great responsibility for pensions and savings funds they have a vested interest in keeping the rate of inflation as low as possible. Their motive is therefore output maximization, not profit maximization.

It must be recognized that any call for the social financing institutions mentioned to engage in the financing of business enterprises is likely to be met with some resistance within the institutions since they have traditionally operated in a very risk-averse manner. In order to motivate the required financing one suggestion would be, in the early stages, for the government to provide full or partial guarantees to these institutions. The social stability value of the proposed investments will certainly justify some degree of government guarantee.

Turning to the government component of the non-market business financing pillar the first point to be made is that government support for private industry will have to be done in a manner which does not run afoul of the WTO regulations on government subsidies. In the developed countries, for example, the extent of R&D support of private enterprise is by no means insignificant. It is for us in the developing countries to find those aspects of our business development which have social implications

enabling us to make a legitimate case for government support.




With money being fungible, the general idea will be to provide enough support to limit the vulnerability of private business to problems emanating in the financial sector. On this score, it would be useful to note that in a real sense Government support of industry in developing countries can be seen as a means of seeking to equalize the effective rates of interest across developed and developing countries. The data presented below show that the interest rates available to business enterprises in the developed countries are substantially lower than corresponding rates in developing countries. Since what government support will do is to limit the exposure of businesses to relatively high rates of interest, this would have the same impact as a reduction in the rates of interest in these countries. On these grounds government support for industry in the developing countries cannot be reasonably cited as a source of unfair trade practices.

**Table Prime Interest Rates in Selected Developed (OECD) and Developing (ACP) Countries**

| | YEAR | | | | |
|---|---|---|---|---|---|
| COUNTRY | 2005 | 2006 | 2007 | 2008 | 2009 |
| United States of America (US)[1] | 7.00 % | 8.25% | 7.50% | 4.00% | 3.25% |
| United Kingdom (UK)[2] | 4.50 % | 5.00% | 5.50% | 2.00% | 1.00% |
| Denmark[3] | 2.40 % | 3.75% | 4.25% | 3.75% | 3.00% |
| Trinidad and Tobago[4] | 9.13 % | 10.96% | 11.75 % | 13.00 % | 13.00 % |
| South Africa[5] | 10.50 % | 12.50% | 14.50 % | 15.00 % | 14.00 % |
| Kenya[6] | 11.50 % | 12.14% | 12.70 % | 12.27 % | 12.00 % |
| Ratio of lowest to highest | **4.8** | **3.3** | **3.4** | **7.5** | **14** |

Source: As stated in footnotes 3 through 8.

The table presents the prime interest rate in three organisations for Economic Cooperation and Development (OECD) member countries namely, the United States, the United Kingdom and Denmark as well as in three developing countries namely, Trinidad and Tobago, South Africa and Kenya over the period January 2005 to February 2009. At a glance it can be observed that the more developed (OECD) countries have significantly lower prime interest rates than their developing (ACP) counterparts. In fact between 2005 and 2009 the ratio of the highest interest rate to the lowest moved from a value of **4.8** to **14.** The case for government support of business in the developing countries would appear to be a very strong one.

The Table below shows the levels of borrowing by the key sectors of interest – Manufacturing and Agriculture. Shares in overall lending are shown as parentheses.

**LOANS BY COMMERCIAL BANKS, MERCHANT BANKS AND FINANCE COMPANIES**

| Sectors | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| Agriculture | 123.3 (.005) | 110 (.003) | 71.5 (.002) | 106.1 (.002) |
| Manufacturing | 2,105.6 (.091) | 2,265.2 (.071) | 2,814.9 (.076) | 2,789.4 (.064) |
| Two-sector Total | 2,228.9 (.096) | 2,375.2 (.074) | 2,886.4 (.078) | 2,895.5 (.066 ) |
| Total Sectors | 22,990.2 | 31,857.2 | 37,051.7 | 43,832.8 |

[1] Refer to Federal Reserve Bulletin, 2009.

[2] Refer to the Institute of Chartered Accountants, 2009.

[3] Refer to Denmark's National Bank, 2009.

[4] Refer to CBTT, Central Bank Data Centre, 2009.

[5] Refer to South African Reserve Bank, 2009.

[6] Refer to Central Bank of Kenya, 2009.

SOURCE: Annual Economic Survey 2007, Central Bank of Trinidad and Tobago, Tables A.22 and A.28.

What the table shows is that the extent of the reliance of the two key sectors on the banking system increased in nominal terms from TT$ 2.2 billion in 2004 to TT$ 2.9 billion by 2007. With the economy growing annually by almost 8% this is somewhat surprising. What is also surprising is, as mentioned earlier, the fact that the share of loans to the key sectors actually fell from 9.6% in 2004 to 6.6% by 2007. If this share were equal to the corresponding 2007 share in the USA – **12.3%** - the figure would be TT$ 4.2 billion **(Federal Reserve Bulletin 2008, Table A.1)**.

Is this figure of TT$ **4.2** billion within the capacity of the non-market sources identified above? Since the new dispensation will need to begin with an initial capitalization of the NDBN this is the minimum figure that would interest us at this stage.

As suggested earlier the NDBN is to be capitalized by new players whose motivation would not be profit maximization. These new players/financiers include –

1. Social security organizations
2. Trade unions
3. Credit unions and
4. The government

These players are known to have pension and other savings funds which are eroded by inflation and as such they will have a vested interest in keeping output high and consequently keeping inflation low.

If we make the assumption that non-government agencies will be prepared to commit a minimum of 10% of their existing asset base to capitalizing the NDBN the result will be as follows:

1. With an asset base (2008) of TT$ 17 billion the National Insurance Board will be able to provide TT$ 1.7 billion (NIB Annual Report 2008, pg. 33)
2. With the OWTU alone reporting a pension fund base of TT$ 8 billion and with the aggregate private pension base in the country estimated at $23 billion pension fund holders can contribute TT$ 2.3 billion (Statement by Christine Sahadeo, Minister in the Ministry of Finance, London Mission, Vol. 28, 2007, pg 3.)
3. With an asset base of TT$ 6.0 billion the Credit Union Movement would be able to provide TT$ 0.6 billion

The total expected to be garnered from savings institutions is therefore approximately TT$ 4.6 billion

If the government commits a minimum of 10% of its long term revenue estimate (TT$ 40 billion) to the capitalization of the NDBN this would give a combined initial capitalization of TT$ 8.6 billion, more than twice TT$ 4.2 billion required.

An important question that arises is whether there is a reasonable argument for diverting government resources to the NDBN for the apparently primary benefit of private capitalists. In this connection it is being suggested that a public goods argument for government support of businesses can be made along the lines that the fragility of the fabric of developing societies means that it takes very little to lead to social unrest since people do not have many options when things go awry. In these countries it is therefore a high social requirement to keep employment and production stable. This is especially true in multi-ethnic societies. A case can therefore be made for public support of industry if that support is linked seeks to political and social stability of the country. In other words what starts off as seeming to benefit one group – the businessmen – really ends up benefitting the entire society.

In this connection it is useful to consider the Canadian situation. Canada is a country that has maintained a very low rate of inflation for a very long time. Moreover, one of the interesting features of the Canadian landscape is the extensive involvement of the government in keeping the business sector properly financed (Canada 2009 budget and before). Both the Business Development Bank of Canada (BDC) and the Export Development Canada (EDC) have turned out to be important vehicles of financing for business in Canada. These are supported by the Canada small Business Financing Program (CSBF), the Self-Employment Program (SE) and Aboriginal Business Canada.

**Conclusion**

In the light of the cataclysmic occurrences in the financial sector over the past few months, and the resulting impact on the economies of the world it is reasonable that as economists we should take a step back and bring forth some fundamental questions about our basic assumptions. There is no question that among the many causes of what has transpired; the propensity to cockiness and the lure of greed have to be highlighted as having played major role in some of the key disastrous decisions that were made. No doubt mistakes were made and we know that to error is human. However, to the extent that we hold to the view that what happened was due purely to human frailty and not to a problem with the system we operate under, we will be setting ourselves up for a more dreadful repetition in the future.

The thrust of this paper is that as useful as the profit motive is a system that is driven mainly by profit will always be vulnerable to instability. Stiglitz has pointed to the human toll of this instability – "families whose life dreams are destroyed as they lose their homes, their jobs, and their life savings."( **Stiglitz, Joseph E**, "Global Crisis- Made in America", SPIEGEL ONLINE, 11/12/2008, pg. 1.) It is in this context that the paper has pointed to two major systemic changes. The first is a more important role for the government in setting up and maintaining a financing network which would prevent the kind of human toll Stiglitz mentions. Second is the involvement of financing institutions which are themselves not driven by profit, but by the desire to keep inflation rates low so that the value of their savings pools will not evaporate.

While the intent of the paper is to contribute to the general discussion on how our thinking as economists should respond to the recent events, the more pertinent objective is to get policymakers in the respective countries and the world at large to start thinking about how our own environment needs to be modified if we are to avoid falling into the situation that has engulfed the more developed economies.

**REFERENCES**

Buffet, Warren in *Berkshire Hathaway Annual Report for 2002*

Central Bank of Kenya, *Annual Economic Review March 14, 2009*

Central Bank of Trinidad and Tobago, *Annual Economic Survey*

Federal Reserve statistical release, March 19, 2009

Federal Reserve Bulletin, 2008

Jickling, Mark CRS Report for Congress, *Containing the Financial Crisis*, Nov., 2008

Krugman, Paul, New York Times, several issues

Stiglitz, Joseph, "The Economic Crisis: Capitalist Fools", Vanity Fair, Jan. 2009