A Crisis of the Overcrowded Future? Shadow Banking and the Political Economy of Financial Innovation

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2007-09:

US mortgage market=>liquidity crunch=>credit crisis=> cross border banking crisis => recession => European stagnation

2007-09: a rather unusual crisis

The crisis was not centred on the collapse of a financial market

Did not involve a classical bank run

Did not involve investor mania or irrational market speculation (cf. Sanches 2014)

It was not a simple credit or equity bubble

Instead

- It was centred on the web of complex opaque and highly bespoke financial products and mechanisms of value creation and value extraction

- 2007 (McCulley): ‘shadow banking’
- The crisis of the ‘shadow banking system’

The central artery of shadow banking is the process of securitisation (financial and legal transformation of assets and ownership)

SB: the literature

- Economic (political-economic)
- Legal
- Functional

4 elements of consensus

1. The term ‘shadow banking’ is unfortunate
2. SB is important to financial stability
3. Shadow banking goes beyond securitisation

Complexity

- Shadow banking involves ‘a set of activities, markets and contracts, as well as institutions; the institutions are linked together via a myriad of multi-step chains’ (Turner 2012)

- Shadow banking entities and products are heterogeneous

Origins

4. Shadow banking is the outcome of regulatory arbitrage in finance

Structured CDOs

2002: $17.5 billion

2006: $307.7 billion

The volume has expanded in response to demand for securitisation-related income, entities and products

2004-2007: escalation in the global demand for CDOs

BlackRock

AUM: $30 billion (hedge fund)

Complex financial firm: $4.401 trillion across all sectors managing clients portfolios of $12 trillion

How to understand the role of SB in political economy?

No single theory seems to provide the answers

- The crisis was a complex phenomenon: shadow credit; consumer indebtedness; Ponzi finance, opaque products
- Unprecedented polarisation of wealth socio-economic inequality (Lysandrou, Piketty)

Debt

- Economic theory: debt is a burden inherited from the past

- False dichotomies between credit and debt, savings and investment, real and financial economies, etc.

- SB: debt is not only a crucial factor of growth but an important institution of financial capitalism

Debt capitalism

- 1971 (Bretton Woods), financialisation, etc.

- Commons (1925, 1934) focused on the legal foundations of capitalism in which ‘the mere expectations of money are converted into money itself’’

Mehrling 2011

The ‘economics view’ resolutely looks through the veil of money to see how prospects for the present generation depend on investment in real capital good that were made by generations past’

But… today the mere expectation of change can be made into value and money

Modern capital

- Is divorced from the obsolete meaning of savings because modern capital comprises intangible property and incorporeal property (Commons 1934: 456)

- Post-Keynesian institutionalism (Atkinson and Whalen 2013)

Futurity

Embodies itself objectively in a present 'economic quantity', Credit, which is the equivalent of debt (Commons)

'Political economy is not a science of individual liberty, but a science of the creation, negotiability, release, and scarcity of debt' (Commons 1934: 390).

Shadow banking

Is the infrastructure for mining, enhancing and shifting debt and its related products into the future and plays a vital role in the operation of the contemporary credit system

Through shadow banking, the financial system has been able to harvest the future for a select group of rich clients. The system erupted when assets generated were unable to get a price in the present.

The crisis of 2007-09 can be seen as the first system-wide breakdown of financial future that has become overcrowded.

In full:

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