End of the economic crisis?

The US and Europe in the light of Keynes and Marx

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Considerations about the Crisis

1. Marx, Keynes, Crisis: A Reprise
2. US and European Economic Growth
3. Aggregate Demand Shortfalls
4. Foreclosures and the Housing Market
5. TBTF Megabanks and Global Finance
6. Quantitative Easing
7. Legacies of the 1980s Crisis: "Structural" and "contractual" lock-ins and the undermining of national law

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1. Marx, Keynes, Crisis: A Reprise

Keynes

- Early Keynes – Value of the pound
- Middle Keynes – Aggregate demand concern
  - Focus on autonomous national growth, multiplier driven…
  - Essay on national self sufficiency (1933)
- Late Keynes – Global concerns:
  - Global surplus recycling mechanism (the Bancor)
  - The need for external balance, hence budget balance
- An absence of attention to problems of power

1. Marx, Keynes, Crisis: A Reprise

Marx

- Contradiction between labor and labor power
- Exploitation: surplus generation as motor force in production

Rational-choice Marxism (Roemer, Elster)

- General theory of exploitation: shift from the employment relation to the wealth relation (differential ownership of productive assets - DOPA)
- Achievement of justice through asset redistribution (always in competitive-market context)
- Later, integration of ideas about endogenous effort in discrimination models

1. Marx, Keynes, Crisis: A Reprise

Extensions of Marx

- Domination-exploitation relation (with Elliott, Devine)
- Markets can be monopolistic – subject to monopoly power (Kalecki – variable markup)
- And participants in markets may have unequal power
  – Using Hirschman's "Exit-voice-loyalty" framework
  – That agent who is able to exit a relationship without loss
  – EG, if you get fired, can you instantaneously find as good a job? (engineers in Silicon Valley in 1990s)
- Social power can be exerted in the process of allocation of wealth assets – a foreshadowing of predatory (sub-prime, pay-day) lending
- Also work by Bowles and Gintis, Lapavitsas

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Figure 0: Annual Percentage Change in Real Gross Domestic Product, 2008-2015: USA, Germany, France, UK

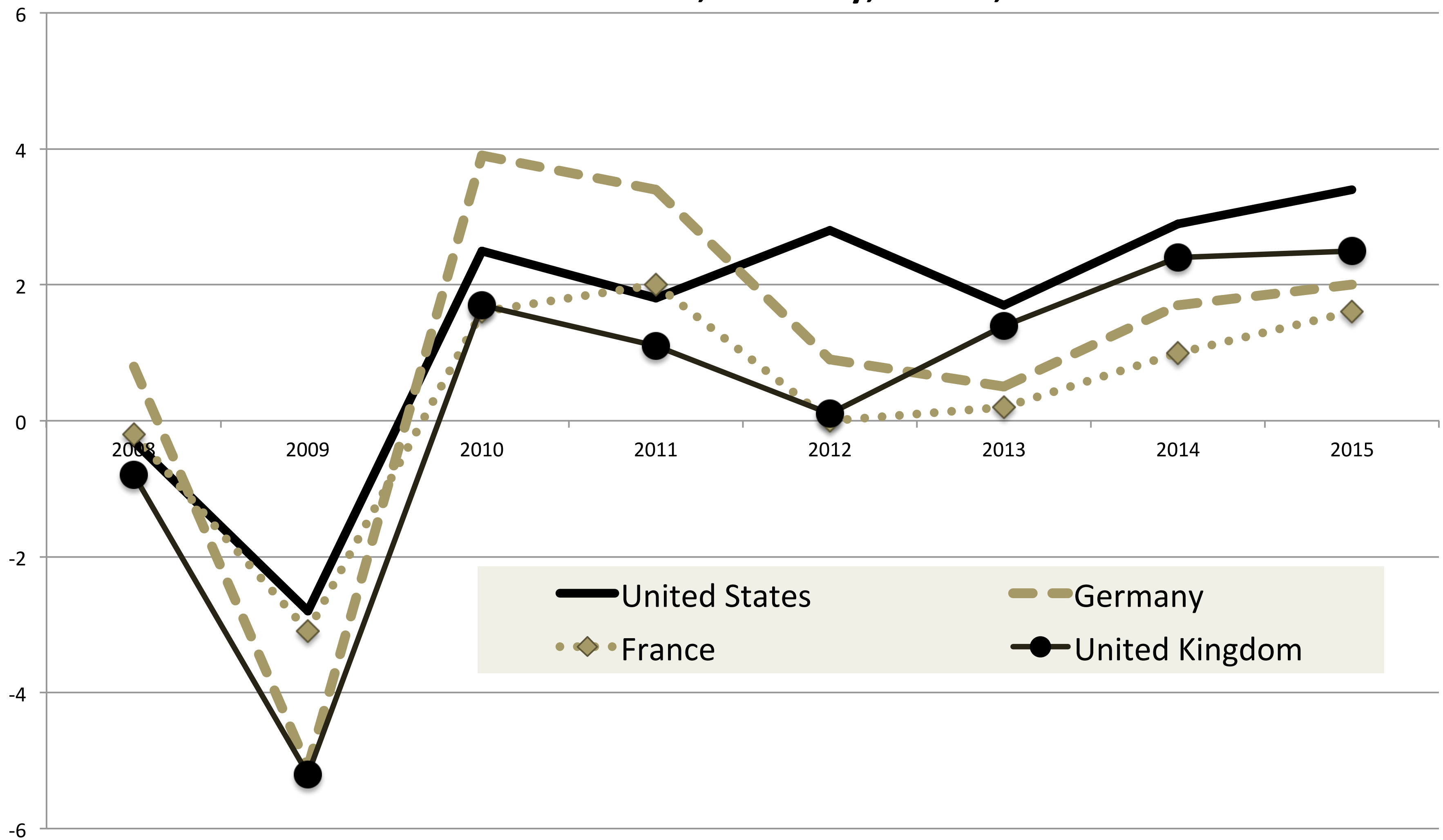
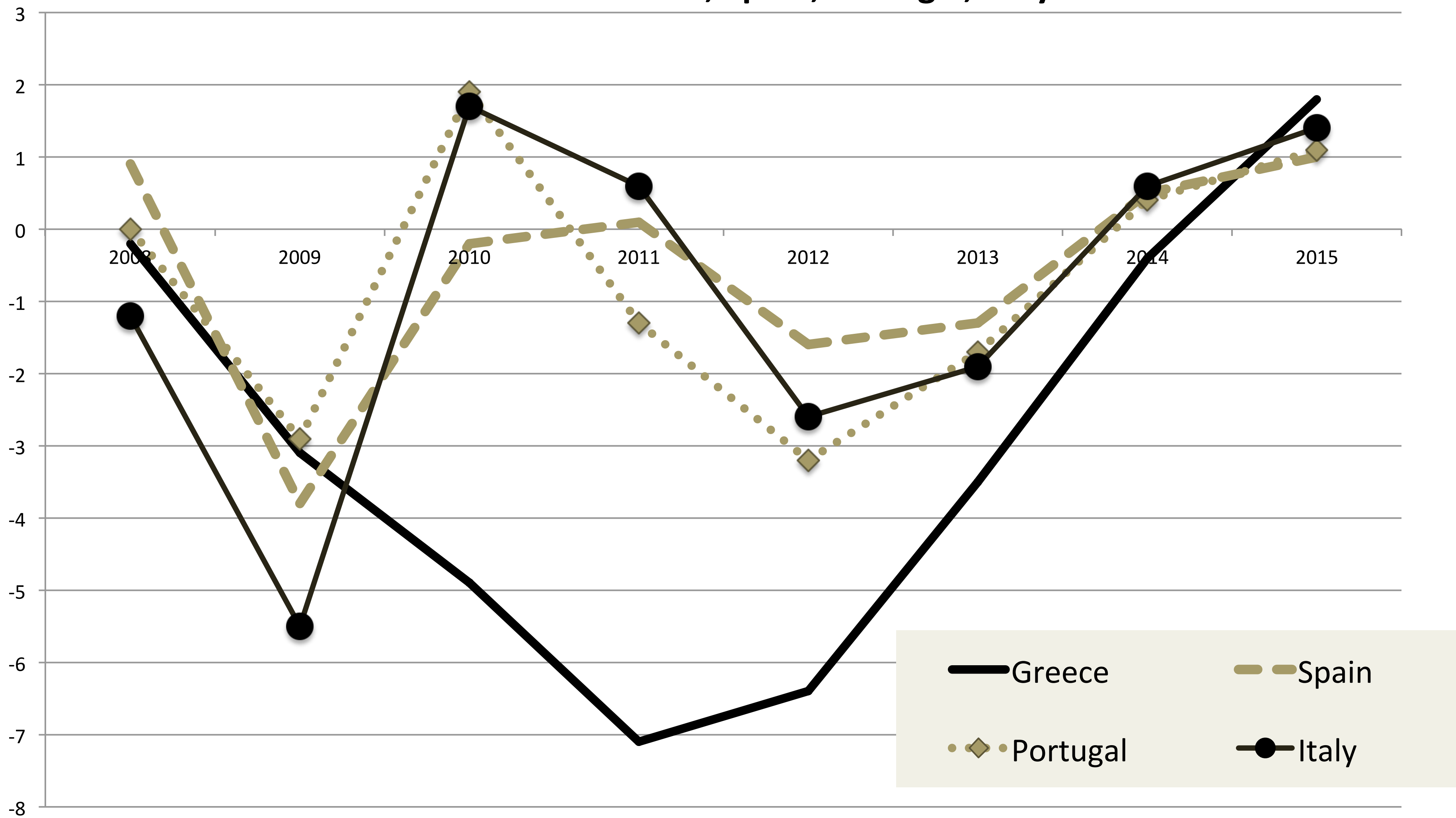


Figure 0: Annual Percentage Change in Real Gross Domestic Product, 2008-2015: Greece, Spain, Portugal, Italy



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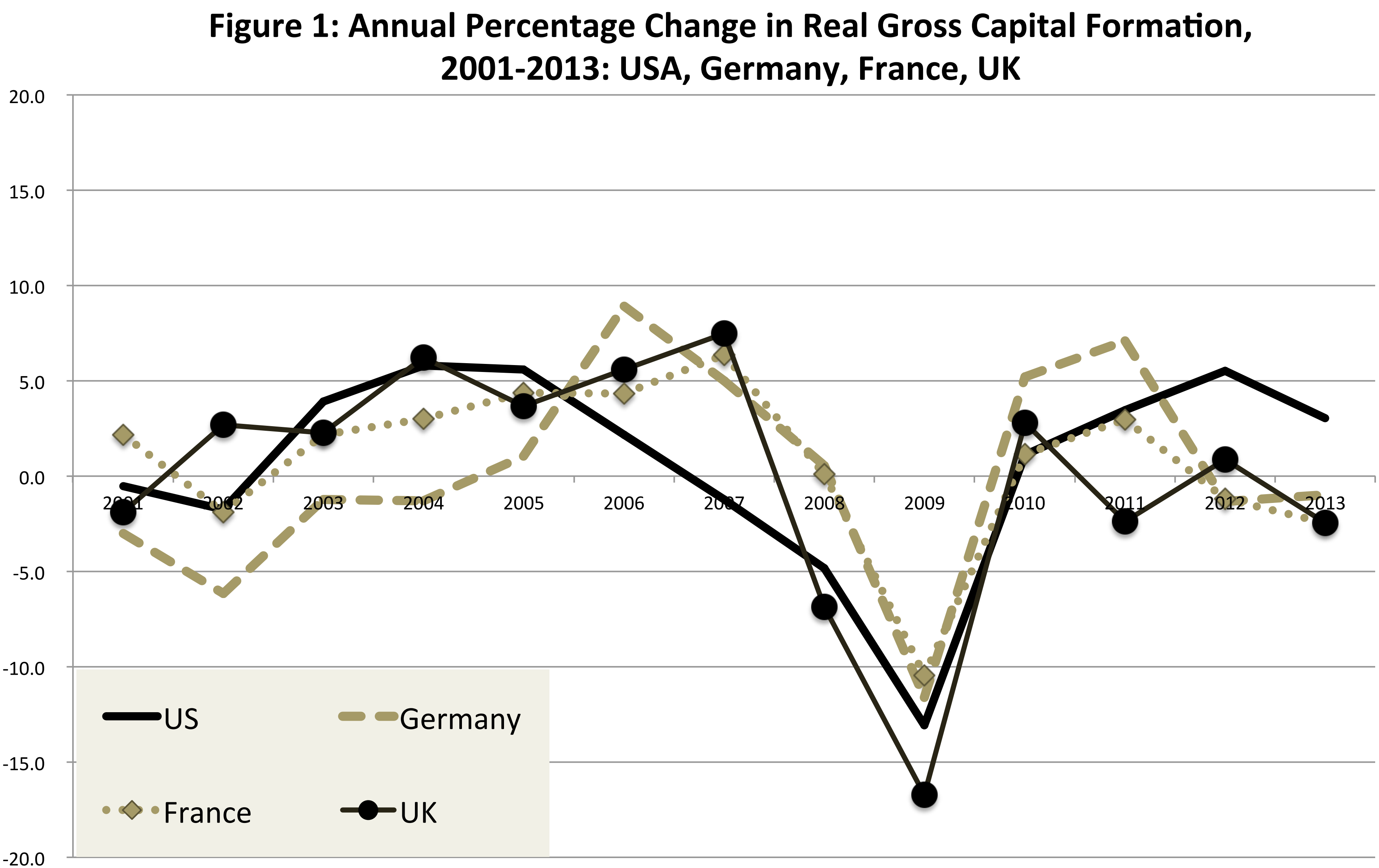


Figure 1: Annual Percentage Change in Real Gross Capital Formation, 2001-2013: USA, Germany, France, UK
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
US
Germany
France
UK

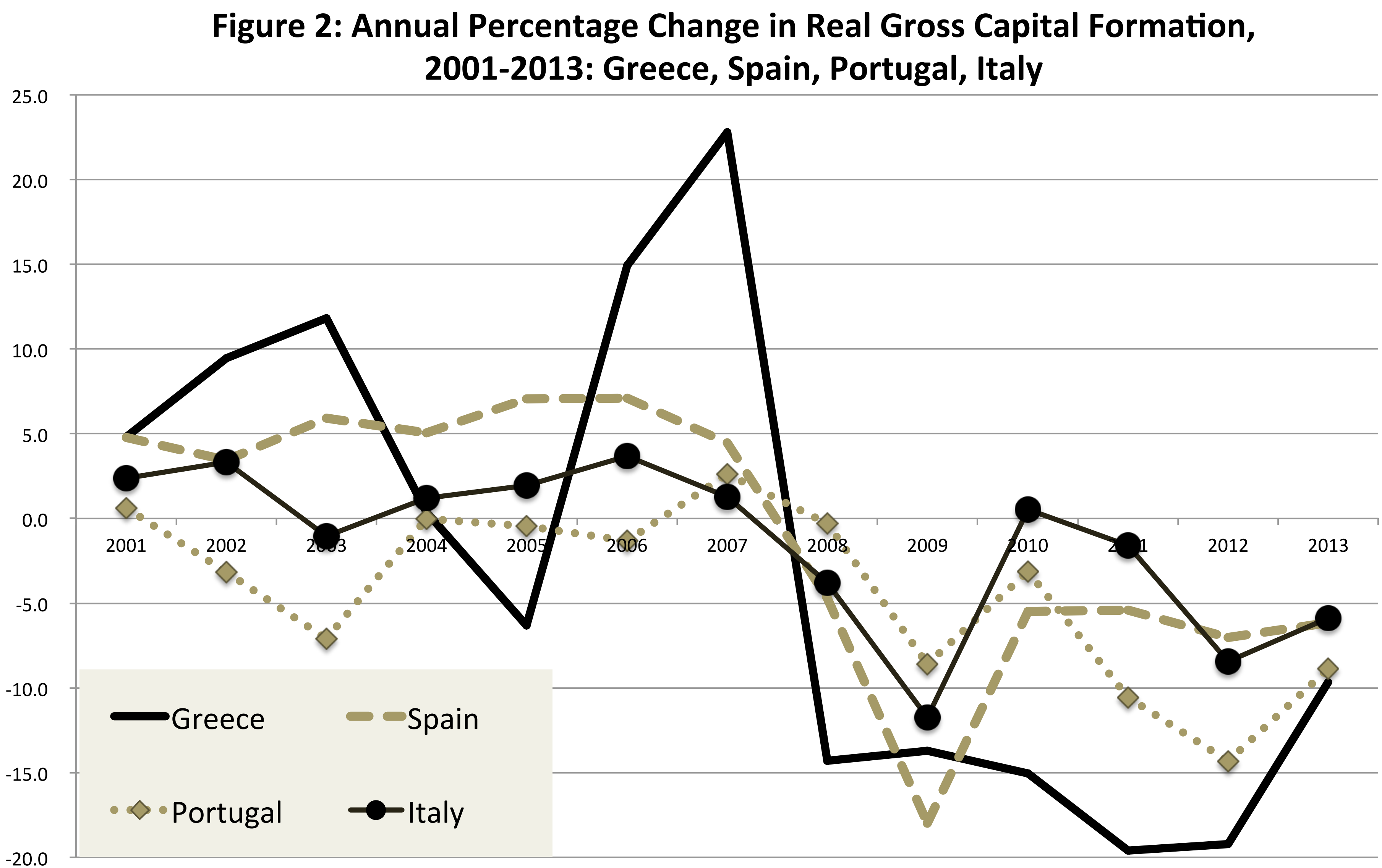


Figure 2: Annual Percentage Change in Real Gross Capital Formation, 2001-2013: Greece, Spain, Portugal, Italy
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Greece
Spain
Portugal
Italy

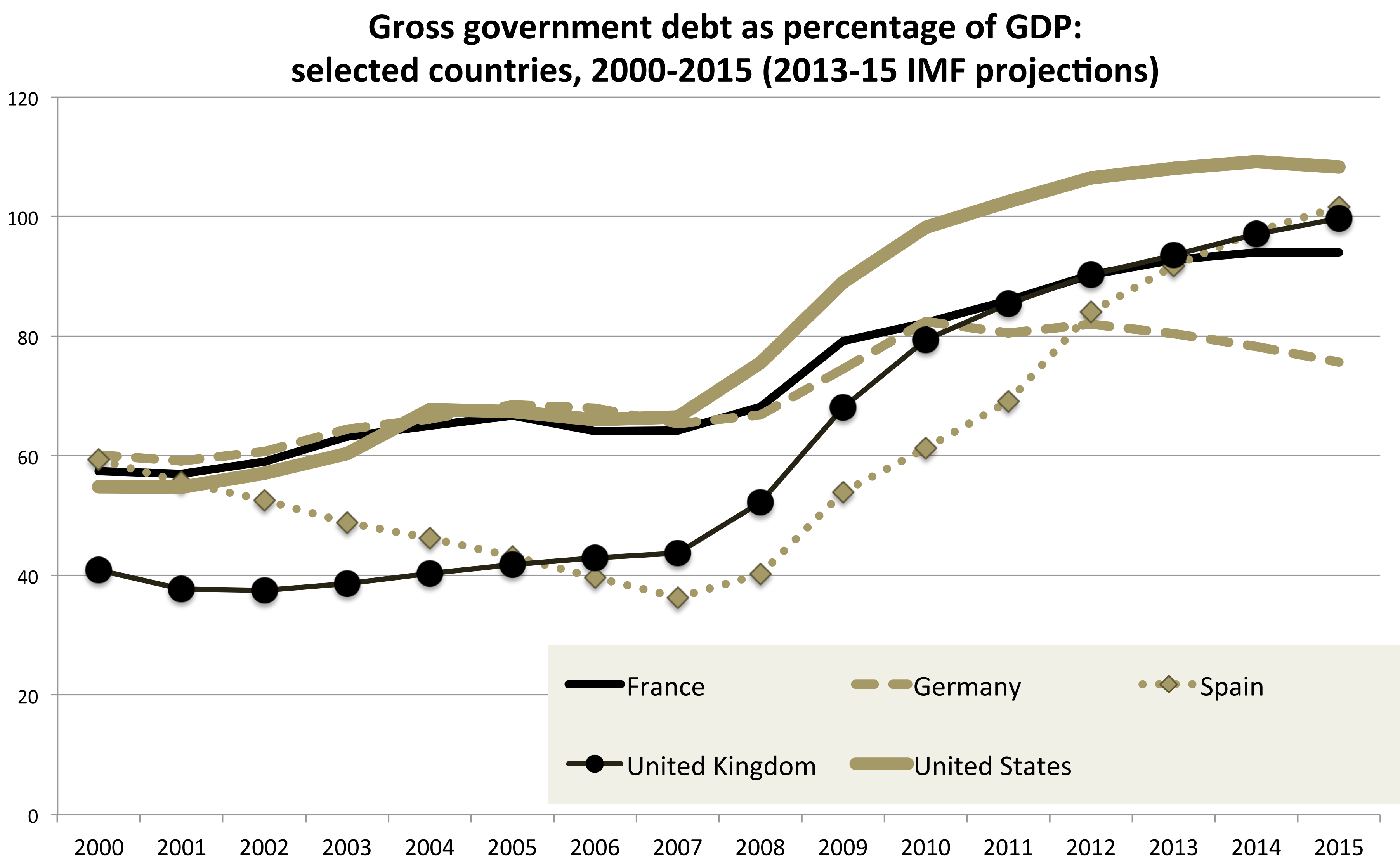
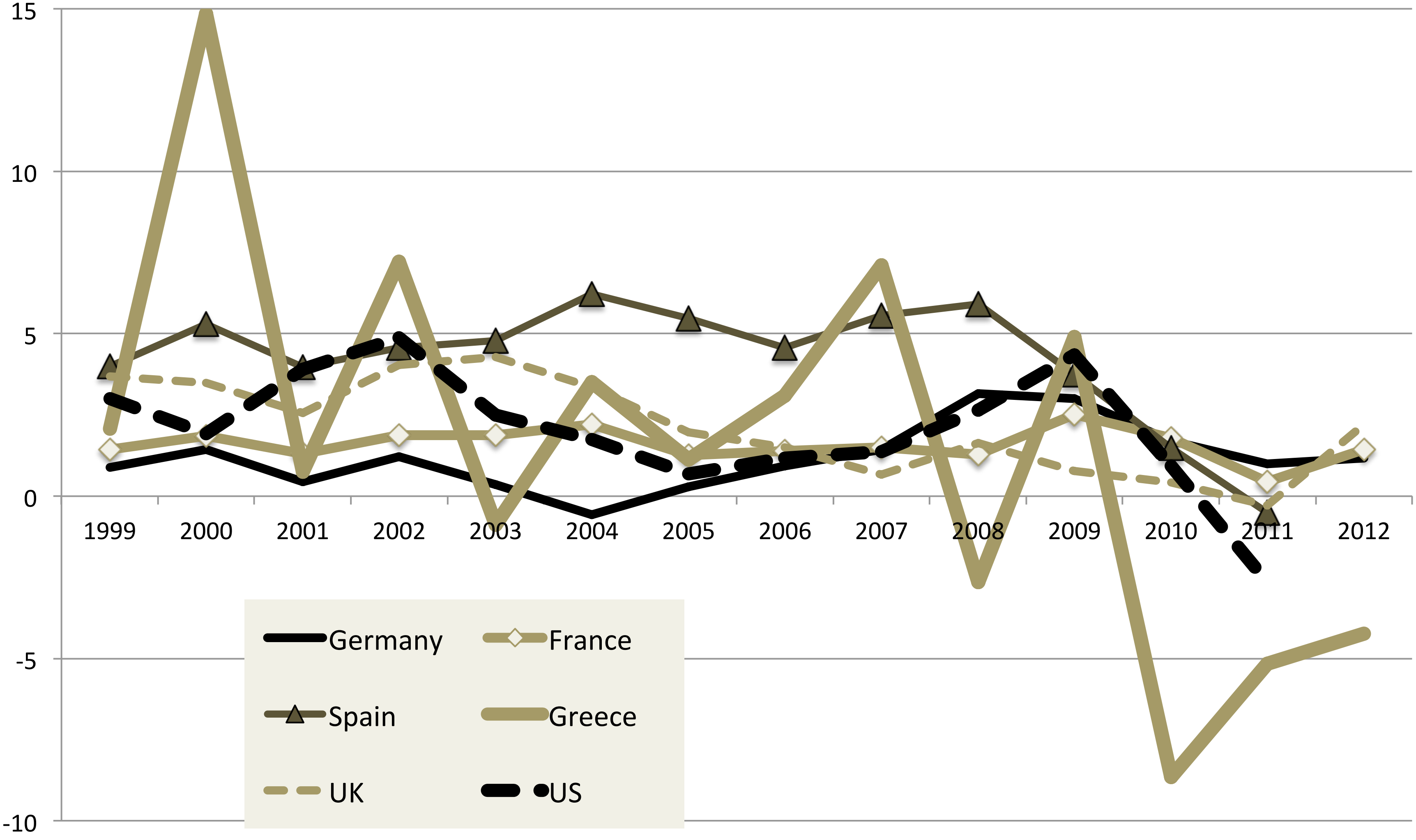
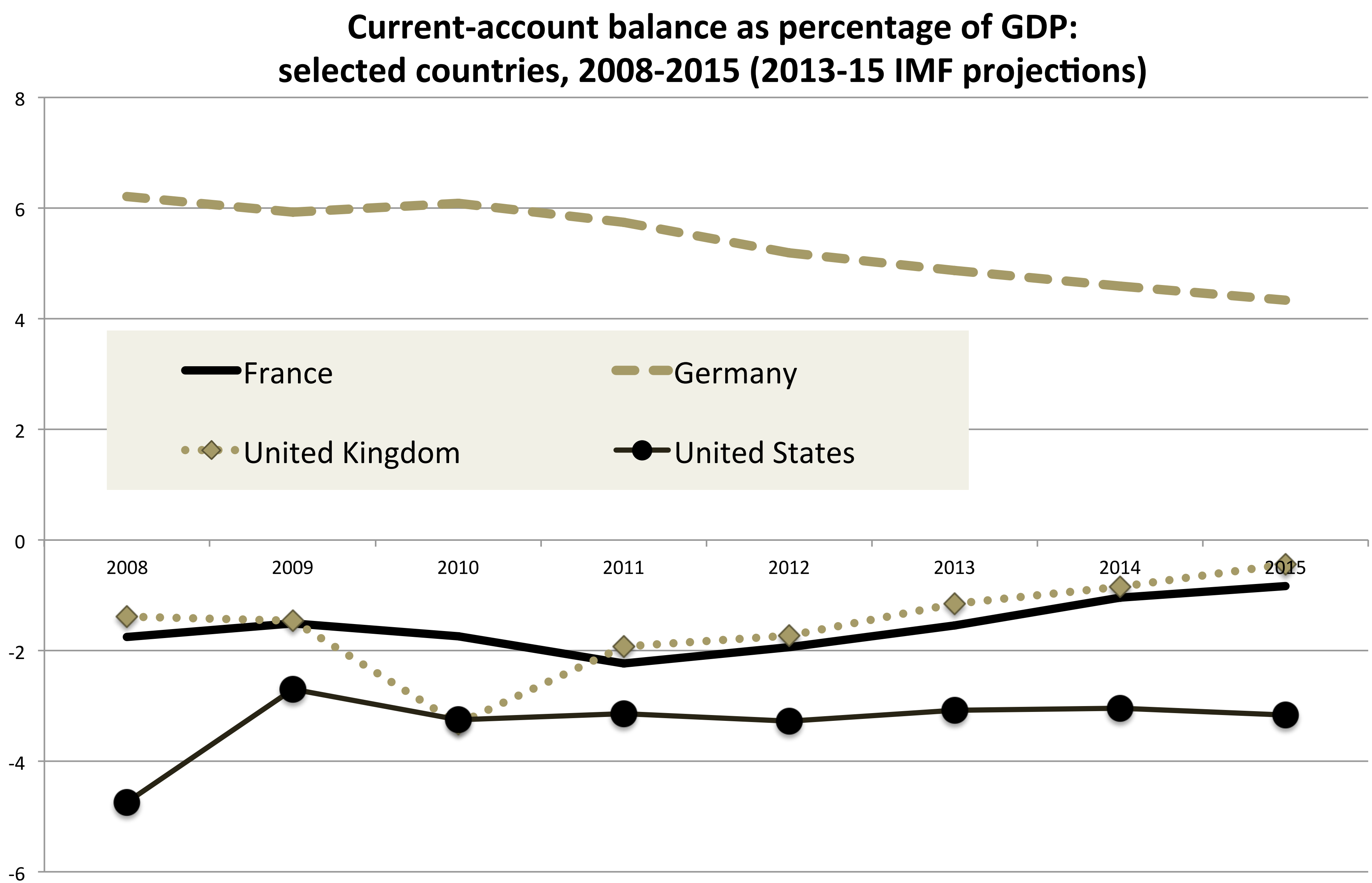

Gross government debt as percentage of GDP:
selected countries, 2000-2015 (2013-15 IMF projections)
120
100
80
60
40
20
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
France
Germany
Spain
United Kingdom
United States

Figure 8: Annual percentage change in real government expenditure, 1999-2012, Selected countries




Current-account balance as percentage of GDP:
selected countries, 2008-2015 (2013-15 IMF projections)
8
6
4
2
0
-2
-4
-6
2008
2009
2010
2011
2012
2013
2014
2015
France
Germany
United Kingdom
United States

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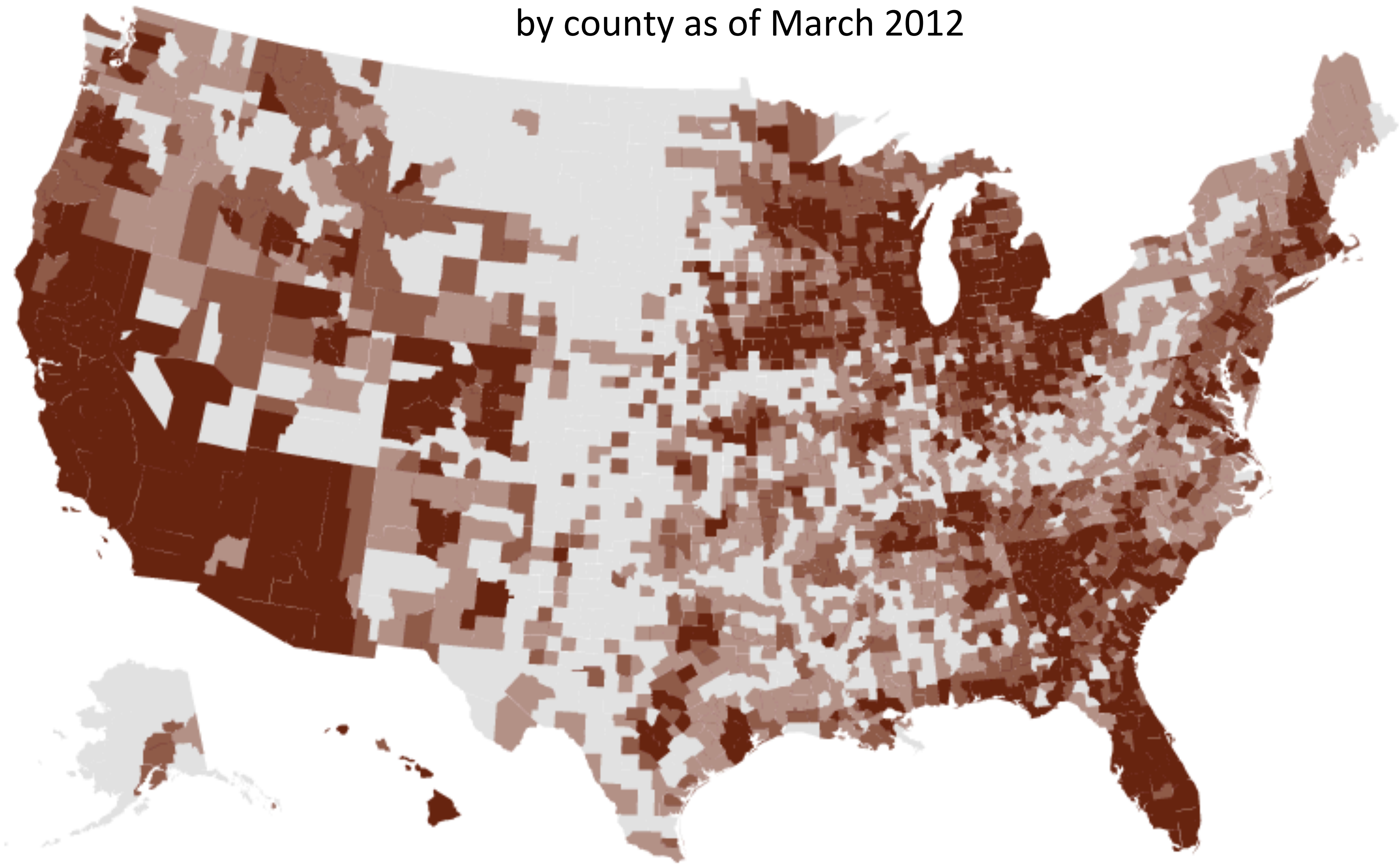
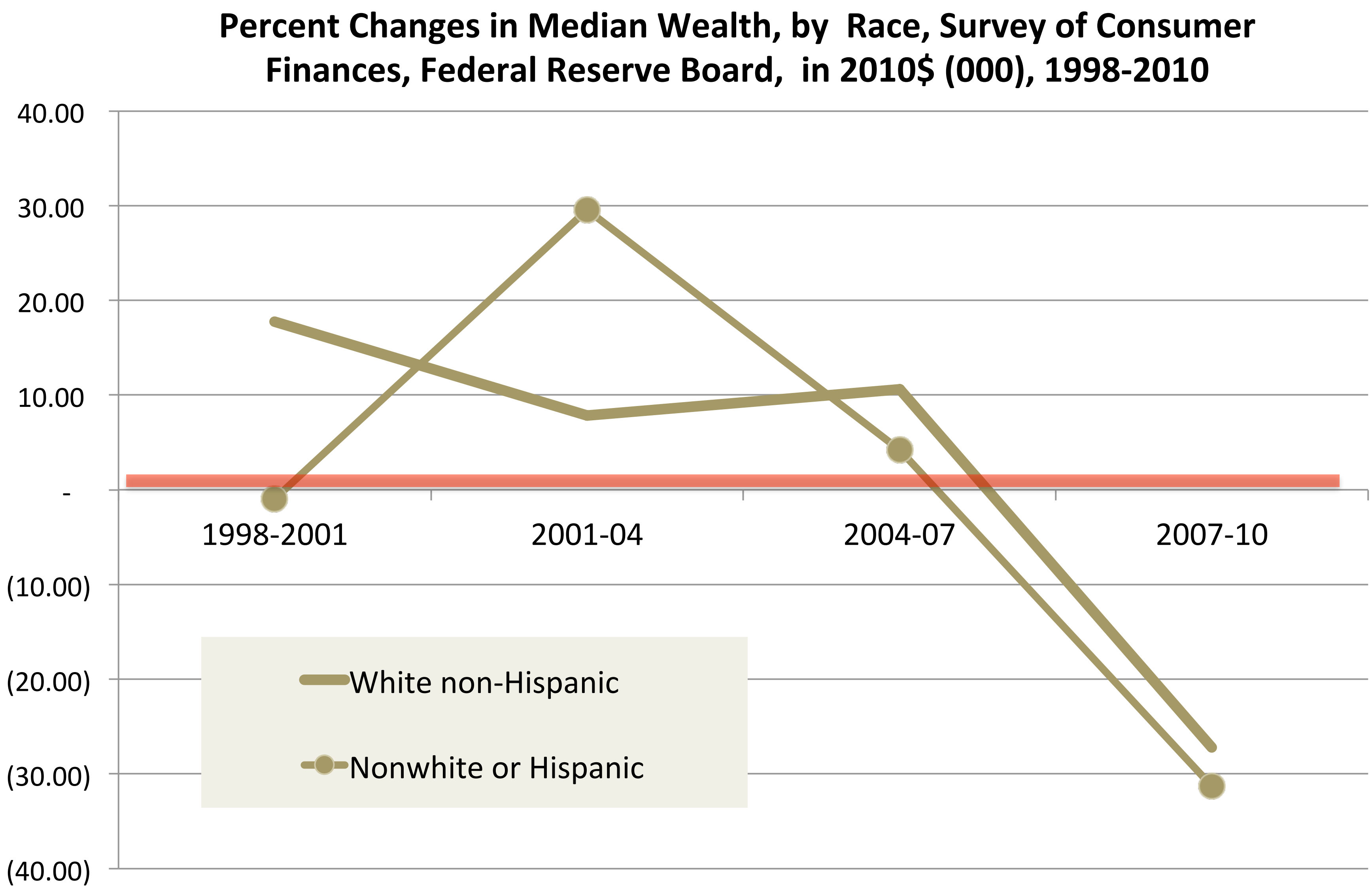
5. Post-crisis scenario and policy/legal responses

- The foreclosure "crisis" has come after the financial crisis was "solved."
- There are no publicly-collected data
- As many as 12 million have lost their homes, more than 1 million in California (up to 8% of all Californians)
- Most apparently move in with families ("doubling up"), some become homeless
- Global speculators (including hedge funds and megabanks) are buying large numbers of foreclosures, converting them to rentals, and securitizing the income.

US Foreclosure rate quintiles (foreclosures/home-owner units) by county as of March 2012



RealtyTrac; taken from http://www.npr.org/templates/story/story.php?storyId=111494514


Percent Changes in Median Wealth, by Race, Survey of Consumer Finances, Federal Reserve Board, in 2010$ (000), 1998-2010
40.00
30.00
20.00
10.00
-
(10.00)
(20.00)
(30.00)
(40.00)
1998-2001
2001-04
2004-07
2007-10
White non-Hispanic
Nonwhite or Hispanic

February 18, 2014, 9:16 pm

Loan Complaints by Homeowners Rise Once More

By JESSICA SILVER-GREENBERG and MICHAEL CORKERY

A growing number of homeowners trying to avert foreclosure are confronting problems on a new front as the mortgage industry undergoes a seismic shift.

Shoddy paperwork, erroneous fees and wrongful evictions — the same abuses that dogged the nation's largest banks and led to a $26 billion settlement with federal authorities in 2012 — are now cropping up among the specialty firms that collect mortgage payments, according to dozens of foreclosure lawsuits and interviews with borrowers, federal and state regulators and housing lawyers.

These companies are known as servicers, but they do far more than transfer payments from borrowers to lenders. They have great power in deciding whether homeowners can win a mortgage modification or must hand over their home in a foreclosure.

Post-crisis scenario and policy/legal responses

New financialized rental-market regime?

- Little relief for distressed homeowners: the property rights of banks and securities owners (hedge funds, etc.) come first
- Banks are avoiding loss declarations on bad loans due to tax-shelter, balance-sheet, and legal-exposure considerations
- "Cramdowns" of loan value, to make housing loans affordable, would cause huge losses for banks and would lead hedge funds to sue banks.
- The problem resides in having two business contracts on one cash-flow: with overseas investors present, a "conflict of laws" problem emerges that banks began resolving in their own interest over 25 years ago.

1. Marx, Keynes, Crisis: A Reprise

Keynes – A Reprise in the Foreclosure Crisis

- An absence of any commitment to aggregate-demand push, to an effort to use public investment in housing or infrastructure to protect workers and people made redundant.
  - Already foreshadowed in the LA uprising of 1992: CDFI (Community development financial institutions) program as a response to the "first multi-ethnic riot"
  - Compare to the 1960s urban riots – "War on Poverty" … Lesson learned for capitalism?
- The legacy: city fiscal crises in the San Joaquin Valley, without relief – municipal bankruptcies (with megabank involvement)

1. Marx, Keynes, Crisis: A Reprise

Marx – A Reprise in the Payday Lending / Foreclosure Crisis

- Domination-exploitation relation – market participants with unequal power
  - 1980-90s: Payday lending, check-cashers, pawnshops as asset-strippers / asset decumulation (short-term credit markets for the poor? (Caskey))
  - 1990s-2000s: Subprime lending: superleveraged lending by vulnerable households bearing housing-price risks
  - After the subprime crisis, an inability to negotiate – the option is to leave the house, lose the house, or stay in and keep paying
  - Banks and megabanks have organized housing price stabilization

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Figure 9: Net Loans and Leases as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012

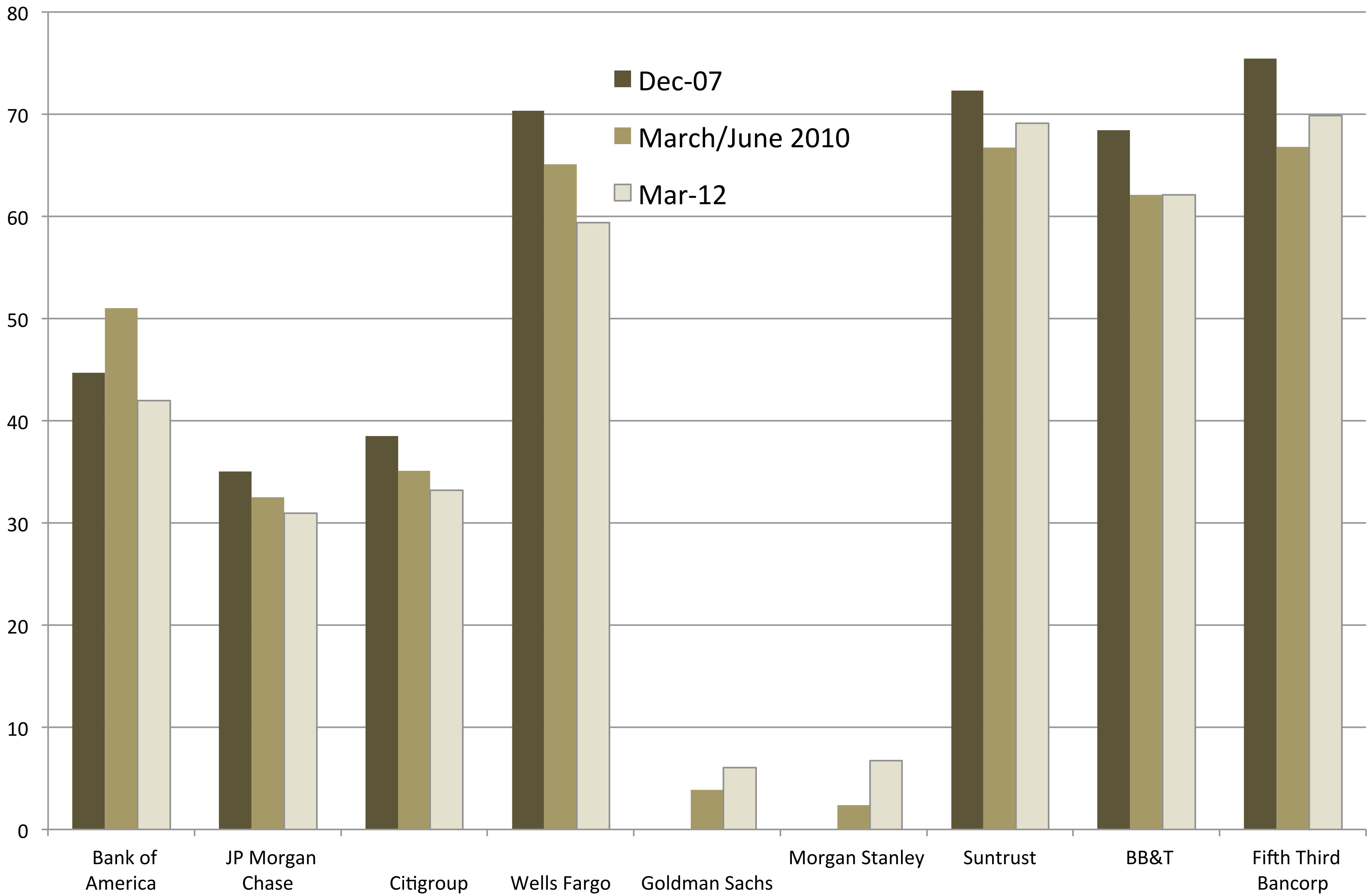


Figure 7: Core Deposits as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012

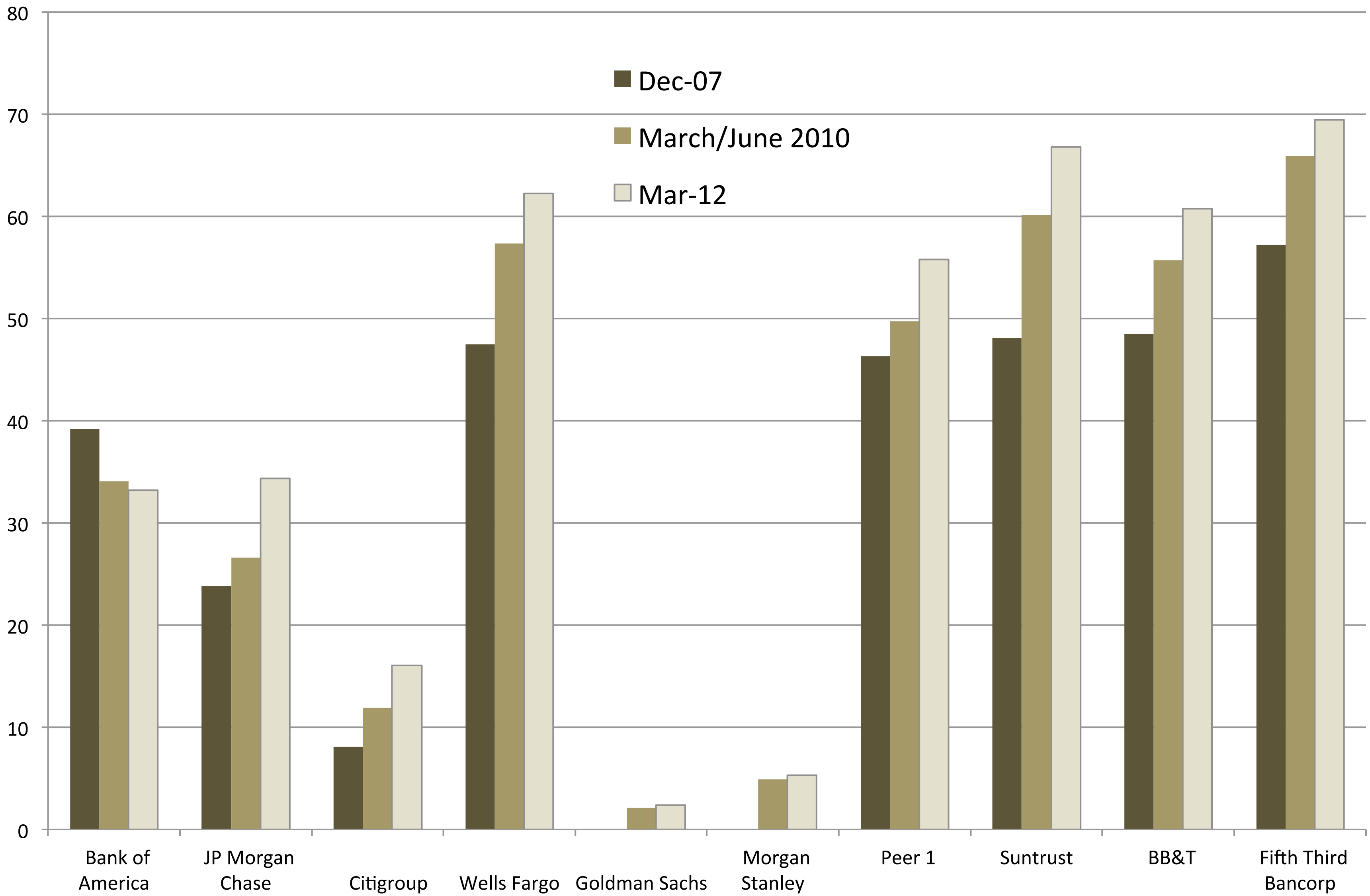


Figure 10: Derivatives as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012

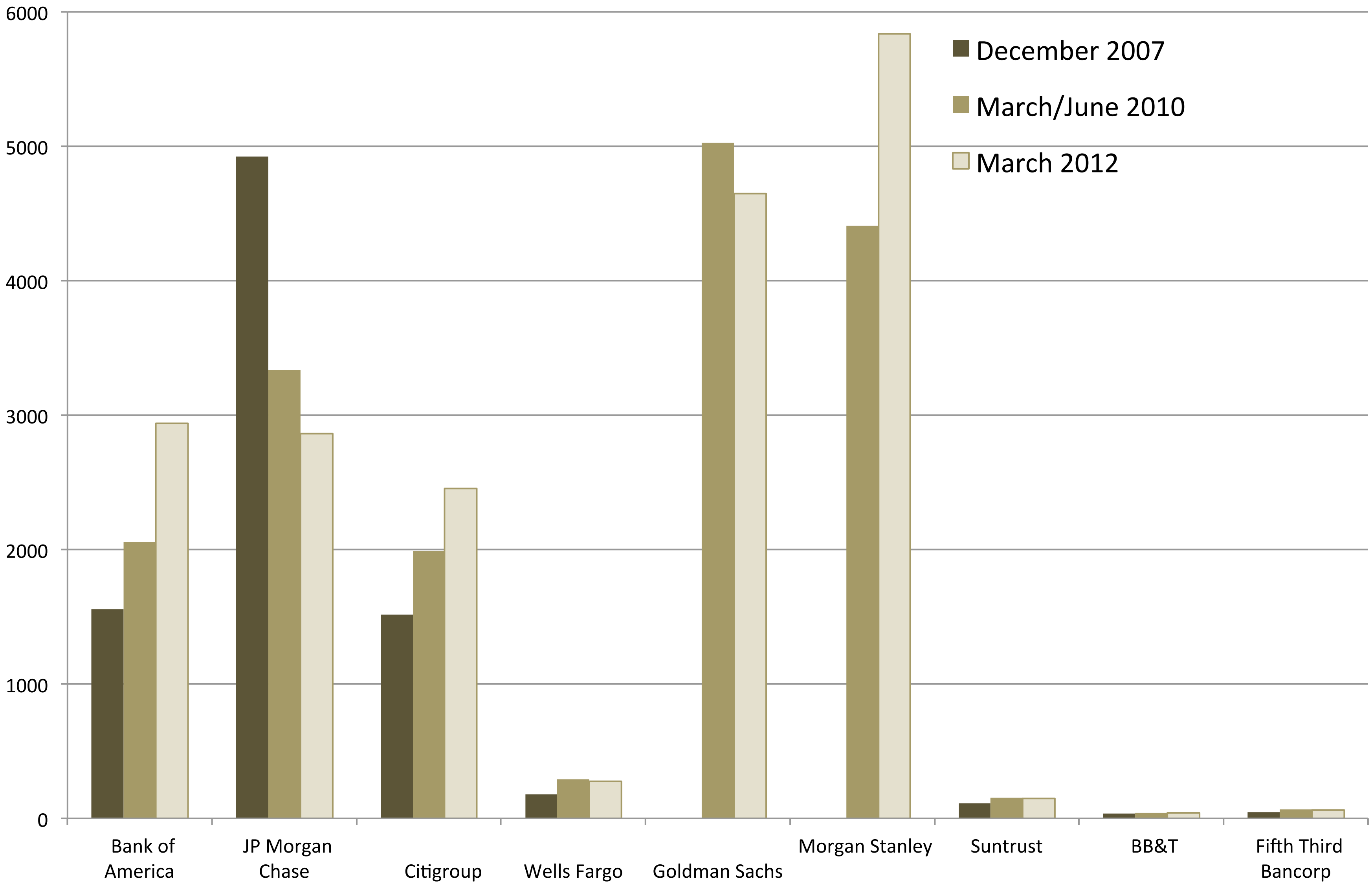
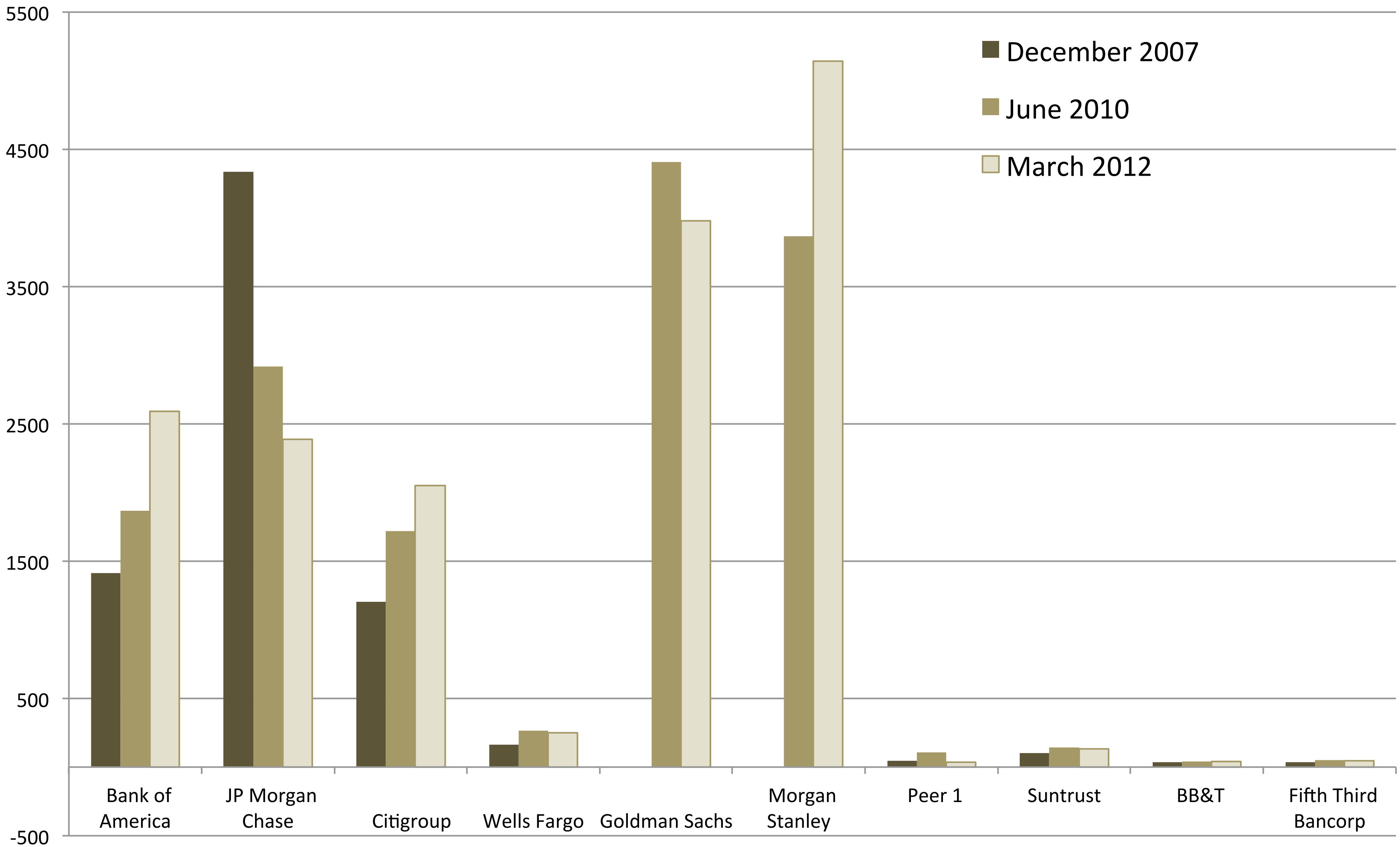
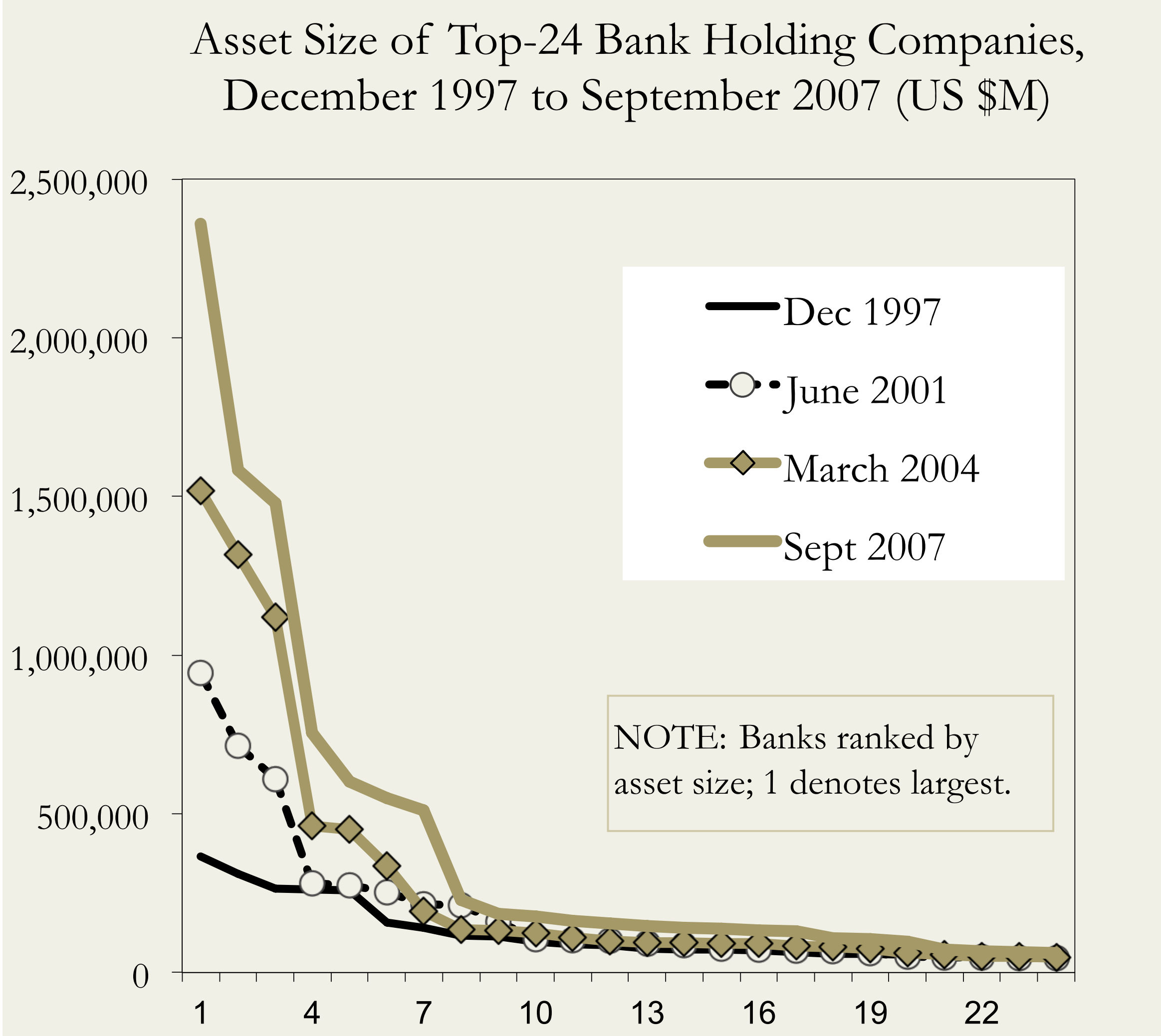


Figure 11: Interest-rate Contracts (Swaps) as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012





Source: National Information Center, FFIEC; FDIC.

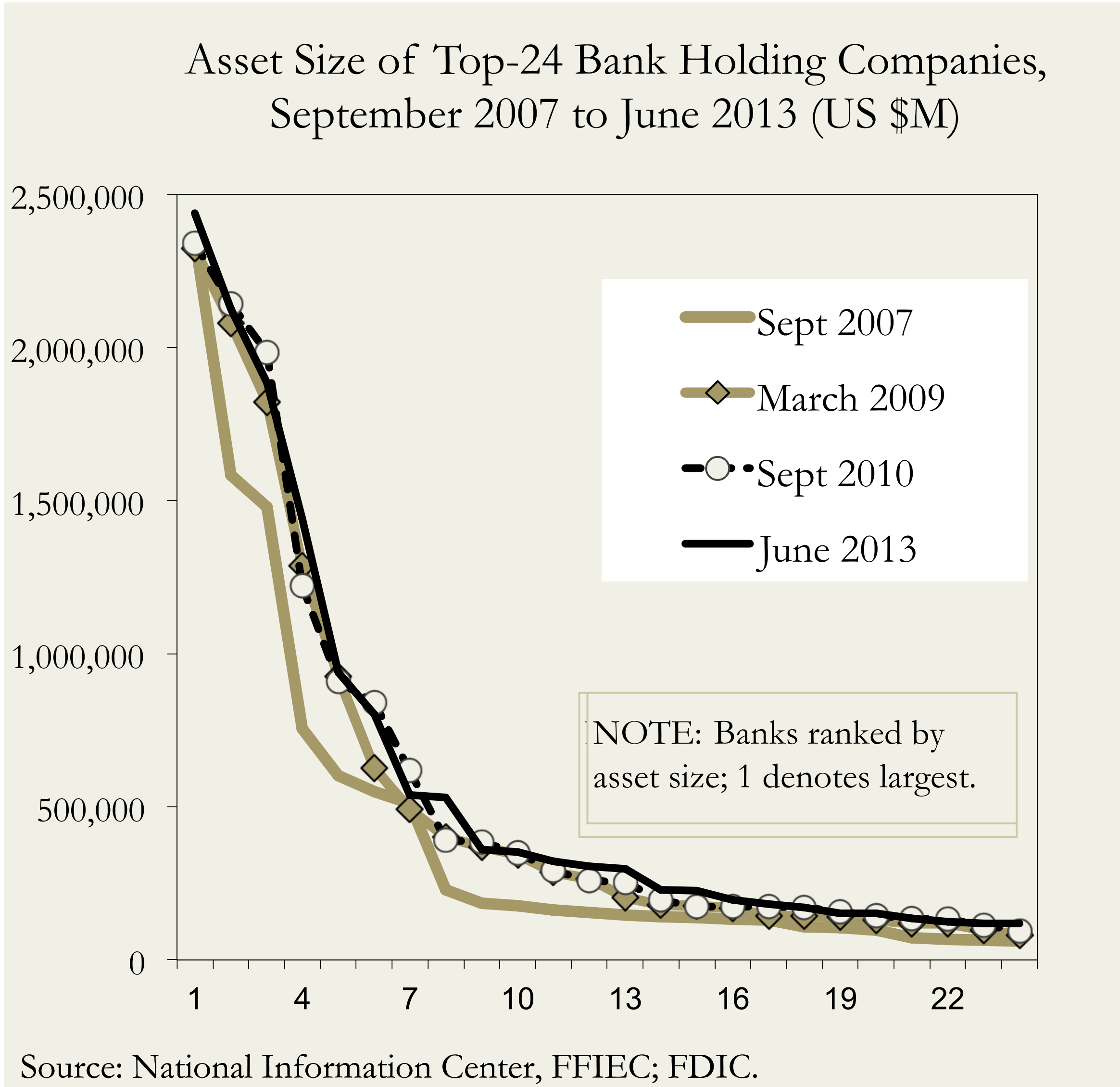
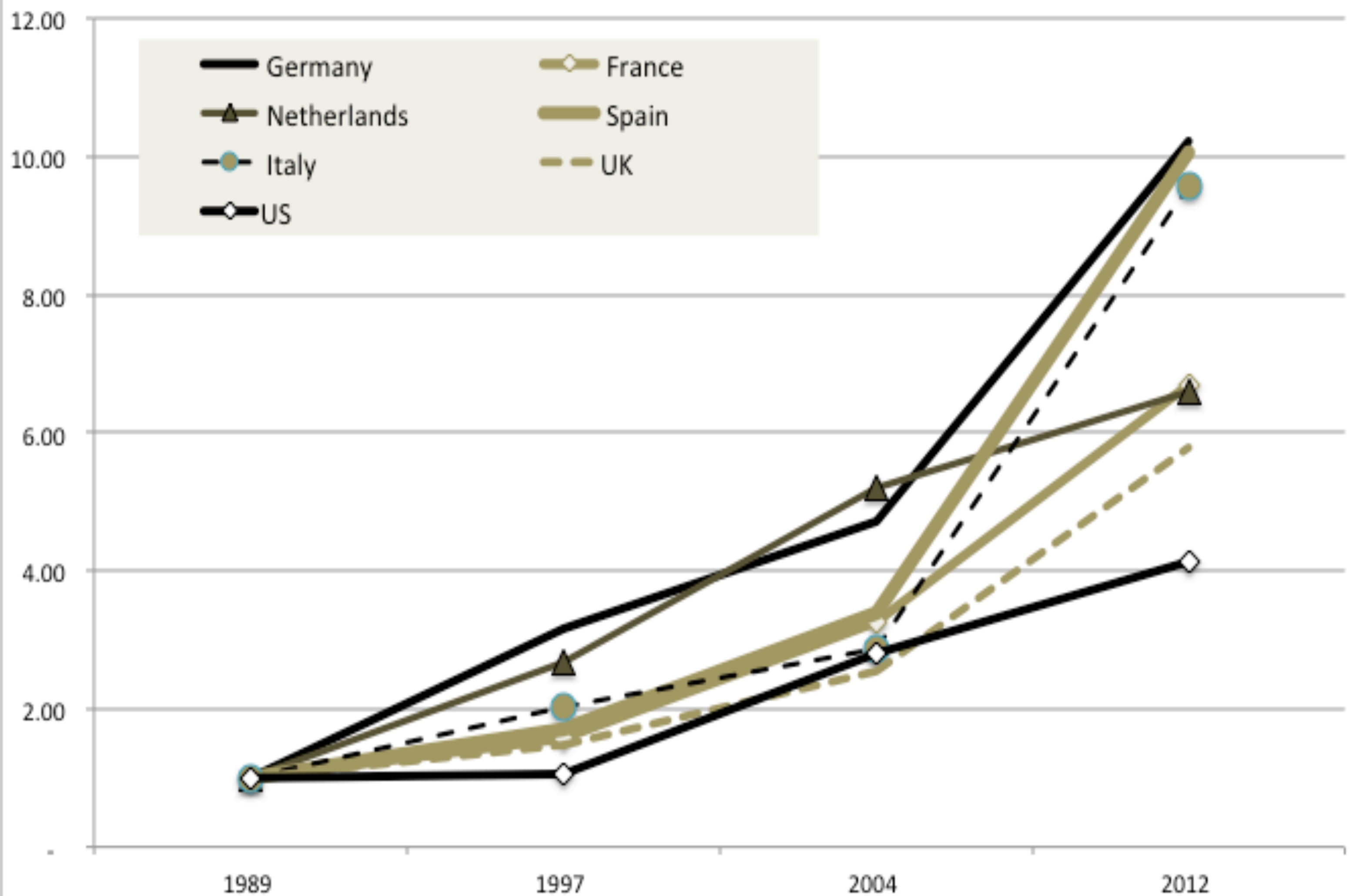

Asset Size of Top-24 Bank Holding Companies, September 2007 to June 2013 (US $M)
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
1
4
7
10
13
16
19
22
Sept 2007
March 2009
Sept 2010
June 2013
NOTE: Banks ranked by asset size; 1 denotes largest.
Source: National Information Center, FFIEC; FDIC.

Figure 14: Assets of the largest domestic bank as a percentage of GDP, selected countries: 1989, 1997, 2004, and 2012 (1989 = 1.0)



1. Marx, Keynes, Crisis: A Reprise

Marx – A Reprise in the Payday Lending / Foreclosure Crisis

- Domination-exploitation relation – market participants with unequal power
  - TBTF banks vs all other banks
  - Which banks failed?
- Megabanks' priority is established through political power
  - The 1999 Gramm-Leach-Bliley Act and Citibank
  - The 1994 Home Ownership Equity Protection Act and Chairman Greenspan's Federal Reserve
  - The Community Reinvestment Act
- Power is exercised through banks' ability to fend off "cramdowns"

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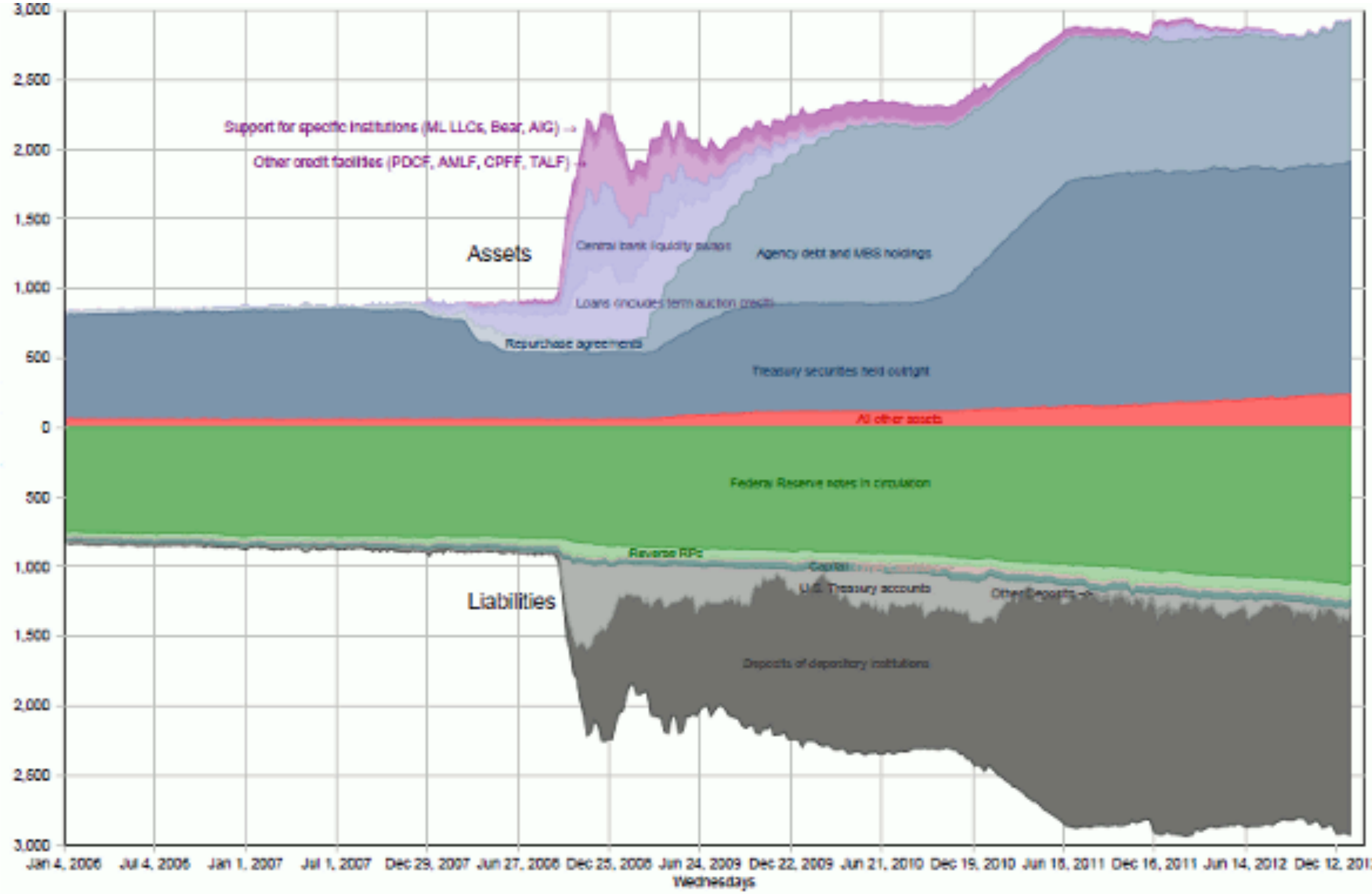

Last updated December 26, 2012.

Considerations about the Crisis

- Quantitative easing and the contemporary "money market"
- Mehrling – Federal Reserve as "dealer of last resort"?
- Super-leverage as a key and continuing feature of financial phase of capitalism? The normalization of accentuated uncertainty to permit normal operations of the TBTF megabanks
- Minsky – 1989 concept of "money manager capitalism"

Money Manager Capitalism, Fiscal Independence and International Monetary Reconstruction

The new money manager financial structure is based upon mutual, pension and trust funds. These funds are arrangements through which the ultimate beneficiaries delegate the management of their wealth to some agent - a money manager. These funds, whose very existence depends upon the success of the economy in avoiding deep depressions, have given birth to power relations which have changed the behavior of capitalist economies. A new managed money capitalism is challenging the dominance of managerial - welfare state capitalism: managers of money are replacing managers of industry as the leading players in the economy.

The dominant trait of money manager capitalism is that individual "savers" or wealth owners have "positions" in funds such as pension funds, mutual funds, insurance reserves or bank managed trusts. These funds are managed by professionals who seek to maximize total returns (cash flow plus asset appreciation). This managed money is volatile across instruments and international boundries.

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Financial globalization and the erosion of Commons' commonwealth:

From Brady bonds to subprime lending to dispossession

Melody Chiong, Gary Dymski, and Jesus Hernandez

Session on "Commons Approach to Social Control in the 21st Century: Firms, Communities and Households as Going Concerns"

AFEE at ASSA Conference, 5 January 2014

Introduction

- We use Commons' approach to capitalism to understand why the 1982 "triple financial crisis" & 2008 subprime crisis had such dire consequences ("lost decade," foreclosures/city stress)
- And to understand the links between them: the resolution of the "triple crisis" undercut sovereignty and commonwealth, and led directly to the subprime crisis, which further undermined sovereignty and commonwealth (and led to Eurozone crisis…)
  - Shifting legal & economic practices rooted in power asymmetries, have forced sovereigns to focus on preserving orderly financial markets and protecting the legal rights of owners of claims on abstract cash flow.
  - So states that should be protecting their citizens' commonwealth have been forced to contract it.

Commons on the transaction and commonwealth

- "Economic theory began with a Commodity as its ultimate scientific unit, then shifted to a Feeling, in order to explain a Transaction which is its practical problem."
- Transactions define economic behavior in any epoch: all activity of any going concern begins and ends with the purchase or sale of goods or services; and this concern's working rules must conform to the rules, obligations, and rights arising from the transactions it undertakes.
- Commons sees "three types of persons, the citizen, the private concern, and the state…" Each, as a going concern, "is more than an entity, it is collective action… it is the working rules that decide the disputes and keep the mass together in support of the rules."

Commons on the transaction and commonwealth

- So institutional economics is a “nationalist theory of value”. … “collective action in control of individual action.”
- “The state is but one of many going concerns;” the nation is defined as a public which possesses and nurtures wealth. Summed wealth equals commonwealth:
  - “The basic principle of the commonwealth … [was] Let any person get rich in so far as he enriches the commonwealth, but not insofar as he merely extracts private wealth from the commonwealth.”
- A disturbing factor is the exercise of power; the “power to withhold opportunities is economic power”
- A problem here is supranational (>national) power.

The 1980s' U.S. "triple financial crisis"

- 1970s ➔1980s: inflation, oil-price spikes, high interest rates, double-dip recession, oil-price collapse, leading to:
   1. 1982: The thrifts providing most mortgage finance were either insolvent or illiquid or both; this led to deregulation in 1982 that led to speculative developments, many of which collapsed
   2. August 1982: Latin American debt crisis (U.S. money-center banks insolvent, six nations in sovereign debt crisis)
   3. Asset-bubble collapse in "oil-patch" states, resulting in July 1982 failure of Penn Square Bank and, in May 1984, to first 'electronic bank run' on Continental Illinois Bank (Chicago)

The 1980s' U.S. "triple financial crisis"

- Resolution of these triple crises:
  1. Continental Illinois: Concerns over CI and over all money-center banks' insolvency (LA crisis) led to September 1984 declaration that 11 banks were "too big to fail"
  2. Latin Amer. Crisis: Creation of Brady bonds, collateralized by US Treasury bonds that were in turn borrowed from IMF or World Bank (or bought by borrower nation)
- Implications:
  1. You now have a category of banks that has escaped national govt oversight insuring their actions add to commonwealth
  2. Each Brady bond was uniquely negotiated; no single solution was available, and national law superceded

“Conflict of laws” and bankers’ collusion

- Buchheit and Reisner (1988) describe as a “fairy tale” a situation before a judicial tribunal where an advocate for a party involved in a sovereign debt restructuring addresses their remarks, “To the International Banking Community”:

  > “For example, the hundreds or thousands of credits that purport to be covered by a restructuring request will have been separately negotiated between borrowers (both public and private sector) and individual banks or, in some cases, ‘syndicates’ of banks lending pursuant to a single loan agreement. These banks, located in countries all over the world, are subject to differing regulatory and disclosure regimes, and have distinct lending and credit review policies and widely divergent practices in important areas such as loan loss reserve provisioning.”

“Conflict of laws” and bankers’ collusion

Lee Buchheit (1988):

- “The enormity and complexity of sovereign debt problems preclude individual banks from negotiating adjustments to their own credit exposure in isolation from fellow lenders.
- “patterns of accepted inter-creditor behavior in these circumstances have evolved without any statutory or regulatory guidelines for reorganizing the financial affairs of a sovereign borrower comparable to domestic bankruptcy or insolvency laws.' What has happened, therefore, has happened only through a consensus among the participants, without the benefit of any outside policy-making authority or enforcement mechanism.”

“Conflict of laws” and bankers’ collusion

Lee Buchheit (1988):

- “The effect of the sovereign debt crisis on inter-creditor relationships has been dramatic and rapid. The international banking community has learned to act as a more or less unitary creditor group. The international banking community has also devised methods to suppress anxieties regarding preferential treatment of certain individual banks, encourage unanimous participation in exercises that are by their nature unanimously unpopular, and discipline those members of the community who may show tendencies toward unacceptably unilateral behavior.”
- What is crucial is that “credit agreements should reflect the banks' entitlement to regard themselves as lenders to the country as a whole, not just separate borrowers within the country”

Lee Buchheit, fairy godmother to finance ministers in distress

Go-to expert for debt-ridden nations on why Spain is the euro's biggest problem, and why he prefers working for debtors

Josephine Moulds
The Guardian, Tuesday 12 March 2013 13.28 EDT

Lee Buchheit: 'The market moves so fast. Hedge funds have the attention span of a Peruvian chinchilla' Photograph: Karen Robinson

Global finance: a higher power

- By acting as a single interest in negotiations with individual borrowers. They avoid any joint-action cabal by borrowers; they also avoid the prospect of continual renegotiations carrying forward into the future. With the Brady bond solutions, the deals have all been cut, and these will end only in debt repayment or debt repudiation. The "certainty" that was indicated as so necessary in the height of the crisis was achieved.
- The principles laid down – bankers' unity in constituting a distinct interest; the opacity of banks' deals to preserve the integrity of the financial relationships they have constructed; the priority given to private negotiations in globalized financial markets, over those of the citizenry in borrower nations – define an approach to the co-existence of global finance and nation-states that subjects Commons' national commonwealths to the prior claims of what is evidently a higher power, in the neoliberal era.

Subprime crisis: Deregulation, TBTF, Securitization

- Mortgage finance: Savings and loan system evaporates in 1980s, replaced first by "plain vanilla" securitization (MBS market), underwritten by FNMA/FHLMC.
  - The Federal government had blocked access of minorities to mortgage credit since the 1930s; and banks had become subject to pressure to "reinvest" in minority communities.
- Then new underwriters emerge, hedge funds/equity funds, broker-based system, emergence of predatory lending – including subprime mortgage loans. So when lending finally starts forcefully in minority neighborhoods, it is a poisoned chalice.
- The Federal government works actively to support megabanks' welfare, ignores legislation that would block emergence / spread of subprime (Federal Reserve does not promulgate regulations for 1994 Home Owner Equity and Protection Act until July 2008).

Subprime loans as Brady bonds

There are close parallels between sovereign debt (Brady bonds) and subprime lending. The parallels include:

1. The many tranches of lenders, each with unique relationships to the underlying debts issued.
2. The different nationalities of the owners of this debt; the fact that this debt is owned by wealthowners across the world, subject to different national rules.
3. The opacity of the debt relationships being traded.
4. Credit-default swaps (CDS) were used to transfer risk from lenders to counterparties.
5. In neither market were "cramdowns" utilized. Other solutions were found when debt repayment was compromised.

A double "double helix" of counterparty obligations

- Three important differences between subprime loans/Brady bonds:
- First, in the case of sovereign debt, the owners directly hold the debt of borrowers; in the case of subprime debt, the owners hold obligations owed to them by banks, who themselves were/are lenders to borrowers who may or may not be able to perform.
  - whereas the Brady bonds were created in the context of the archaeology of years of prior contracts, the subprime securitizations *start out* that way. They are complex, multiparty, opaque, and un-unwindable – *by design*. They constitute a non-negotiable demand on the resources of the nation-state by 'lenders'/investors who have agreed to terms and contracts with the megabanks that retailed these bundled loans. The "original borrowers" and the communities in which those borrowers live – or once lived – are not part of that game.

A double “double helix” of counterparty obligations

- Second, like Brady bonds, subprime securities gave rise to risk that was insured on the original payment contract, and traded in the market as a CDS. But the subprime market also permitted the creation of CDS based on synthetic (non-existent) CDO market.
  - The problem arises because these obligations are traded over the counter; so the buyer is not aware of how much total CDS exposure the seller has assumed.
- Third, in the Brady countries, the loans that failed were typically for industrial development or resource exploration or extraction; their failure resulted in bankruptcies and business failures, and in the loss of stable employment. In the subprime case, however, the individual borrowers were not linked to industrial policy or business development; instead, they were seeking to improve their individual circumstances by achieving homeowner status.

“Conflict of laws” and bankers’ collusion

- The Latin American debt crisis of 1982 (and after) resulted in the largest US banks having negative equity positions. The question was how to resolve this.
- Buchheit and Reisner (1988) pointed out the problem:

> “… These banks, located in countries all over the world, are subject to differing regulatory and disclosure regimes, and have distinct lending and credit review policies and widely divergent practices in important areas such as loan loss reserve provisioning.”
>
> “The enormity and complexity of sovereign debt problems preclude individual banks from negotiating adjustments to their own credit exposure in isolation from fellow lenders.”

Eurozone crisis and bankers' collusion

- Eurozone bonds: diverse origins of European national debt – but all roads lead to .. Berlin(?)
- These bonds also have double claimants on single fragile cash-flows;
  - And the final holders dictate terms for any renegotiation
  - The solutions are supra-legal / not anticipated or encompassed in European law
  - Irresponsible sovereigns / governments are now not able to protect the irresponsible households and businesses that reside within their borders; everyone must work harder, pay more, take less, live cheaper, so the 1% can thrive
    - Picketty's "Capital in the 21st Century" a harbinger of things to come. "If you can't beat 'em, join 'em?"