THE TYRANNY OF GLOBAL FINANCE

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Summary

Against all expectations, financial capital has emerged even stronger after the financial crisis having staved off regulation and having successfully put the blame on public spending. But its victory is likely a pyrrhic one as a new crisis looms, one in which the global public could learn from victories such as reforms in Iceland and finally reassert its control over money.

ILLUSTRATION NOTE

The Trujillo family in Denver worries about the future after being evicted. 5 million people lost their homes in the US in the first five years after the subprime mortage crisis as a result of reckless lending and speculation by the US banking industry. Yet reforms of the banking sector have been partial and completely insufficient.

Nearly eight years after the outbreak of the global financial crisis, it is evident that those who were responsible for bringing it about have managed to go completely scot-free. Not only that, they have been able to get governments to stick the costs of the crisis and the burden of the recovery on their victims.

"My administration is the only thing that stands between you and the pitchforks".

Finance capital has not simply shrugged off popular anger and staved off government efforts to regulate it, as in the USA. It has also used the power of the state to quell democratic revolts against it, as in Greece. Finance capital has been the single biggest factor discrediting liberal democracy in the last few years. In the face-off between democracy and finance, there have been few instances in which the latter has prevailed, indeed, only one: Iceland.

Wall Street under assault

When the ground from under Wall Street opened up in autumn 2008, there was much talk of letting the banks get their just desserts, jailing the "banksters", and imposing draconian regulation. There was deep disgust with the massive $700 billion bailout of the country's biggest banks by the Bush Administration on the rationale that they were "too big to fail". The move was rightfully condemned in many quarters as being concocted by Wall Street's men in Washington, chief of whom was Treasury Secretary Hank Paulson, whose earlier incarnation was CEO of the premier investment bank Goldman Sachs.

There were widespread expectations that with Barack Obama taking over as president in the depths of the crisis and the Democrats winning control of the House and Senate, banking reform was just around the corner. The new president captured the mood of the country when he warned Wall Street, "My administration is the only thing that stands between you and the pitchforks".[1]

Domestic support in the USA for fundamental financial reform was accompanied by international clamour for tougher regulation of the banks.

When the G-20 met in Pittsburgh in the depths of the financial maelstrom in November 2009, two measures were uppermost in the reform agenda approved by the participants. One was maintaining powerful stimulus programmes to ignite economic recovery. The other was to effectively regulate the financial sector. As the G-20 Leaders' Communiqué put it, "Where reckless behavior and a lack of responsibility led to crisis, we will not allow a return to banking as usual".[2]

Defensive warfare

Finance capital and its allies were able to contain both thrusts and launch a counter-offensive that made citizens pay the price for the economic mess.

The first line of defence was to get the government to rescue the banks from the financial mess they had created. The banks flatly refused Washington's pressure on them to mount a collective defence with their own resources. Then they got their advocates in Washington to argue that they were "too big to fail" – that is, that any one of them going down would bring the whole global financial system with it. Using the massive collapse of stock prices triggered by Lehman Brothers going under, finance capital's representatives were able to blackmail both liberals and the far-right in Congress to approve the $700 billion Troubled Asset Relief Program (TARP). Nationalisation of the banks, which could have been an option that would not involve what 'Nobel' Economics Prize winner Joseph Stiglitz would characterise as "a great robbery of the American people"[3] was dismissed as being inconsistent with "American" values.

The incoming Obama Administration promised substantive reform, but by engaging in the defensive anti-regulatory war that they had mastered in Congress over decades, the banks were able, in 2009 and 2010, to gut the Dodd–Frank Wall Street Reform and Consumer Protection Act of three key items that were seen as necessary for genuine reform: downsizing the banks; institutionally separating commercial from investment banking; and banning most derivatives and effectively regulating the so-called "shadow banking system" that had brought on the crisis. According to Cornell University's Jonathan Kirshner,

> [The] Dodd Frank regulatory reforms, and provisions such as the Volcker rule, designed to restrict the types of risky investments that banks would be allowed to engage in, have … been watered down (or at least waterboarded into submission) by a cascade of exceptions, exemptions, qualifications, and vague language… And what few teeth remain are utterly dependent for application on the (very suspect) will of regulators.[4]

Decisive in securing this outcome was what Cornelia Woll termed finance capital's "structural power". One dimension of this power was the $344 million the industry spent lobbying the US Congress in the first nine months of 2009, when legislators were taking up financial reform.[5] Senator Chris Dodd, the chairman of the Senate Banking Committee, alone received $2.8 million in contributions from Wall Street in 2007–2008. But perhaps equally powerful as Wall Street's entrenched congressional lobby were powerful voices in the new Obama Administration who were sympathetic to the bankers, notably Treasury Secretary Tim Geithner and Council of Economic Advisors' head Larry Summers, both of whom had served as close associates of Robert Rubin, who had successive incarnations as co-chairman of Goldman Sachs, Bill Clinton's Treasury chief, and chairman and senior counsellor of Citigroup. More than anyone else, Rubin has, over the last two decades, symbolised the Wall Street–Washington connection that dismantled the New Deal controls on finance capital and paved the way for the 2008 implosion.

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Over a period of nearly 20 years, Wall Street had consolidated its control over the US Treasury Department, and the appointment of individuals that had served in Goldman Sachs, the most aggressive investment bank on Wall Street, to high positions became the most visible display of the structural power of finance capital. Rubin and Hank Paulson, George W. Bush's Secretary of the Treasury, were merely the tip of the Goldman Sachs iceberg at the centre of Washington politics.

While traditional fraudsters such as Bernie Madoff were prosecuted and jailed, the chiefs and lieutenants of the biggest financial institutions, who had caused infinitely greater damage, were untouched. The worst punishment that the CEOs of the errant financial institutions got was a few million dollars shaved off their multi-million dollar severance packages.

Changing the narrative

Finance capital not only successfully resisted effective re-regulation by deploying its structural power. It was also able to successfully wield its ideological power, or perhaps more accurately, it was able to hitch its defence to the dominant neoliberal ideology. Wall Street was able to change the narrative about the causes of the financial crisis, throwing the blame entirely on the state.

This is best illustrated in the case of Europe. As in the USA, the financial crisis in Europe was a supply-driven crisis, as the big European banks sought high-profit, quick-return substitutes for the low returns on investment in industry and agriculture, such as real-estate lending and speculation in financial derivatives, or placed their surplus funds in high-yield bonds sold by governments. This is not to say that there was not an element or irresponsibility on the part of some governments, such as the case of Greece. It is to say, however, that the search for profits by ultra-competitive financial actors was the major driver of capital flows. As Martin Sandbu writes in his superb analysis of the European debt crisis,

> From the late 1990's, banks and other financial institutions throughout the world – not just in the Eurozone – engaged in an enormous ramp-up of lending which governments did little to restrain. More than anything, it is this global credit bubble that is to blame for the compression of borrowing costs everywhere, inside the euro and outside it. If financial markets priced a loan to Athens as if it were as safe as one to Berlin, this was because financial actors got caught up in a hunt for returns in which they abandoned any sensitivity to risk.[6]

In the case of Greece, German and French private banks held some 70% of the country's 290 billion euro debt at the beginning of the crisis. German banks were great buyers of the toxic sub-prime assets from US financial institutions, and they applied the same enthusiasm to buying Greek government bonds. For their part, even as the financial crisis unfolded, French banks, according to the Bank of International Settlements, increased their lending to Greece by 23%, to Spain by 11%, and to Portugal by 26%.

Indeed, in their drive to raise more and more profits from lending to governments, local banks, and property developers, Europe's banks poured $2.5 trillion into Ireland, Greece, Portugal and Spain. It is said that the fact that these countries' were in the Eurozone "deceived" the banks into thinking that their loans were safe since they had embraced the same tough rules for membership in the same currency union to which Europe's strongest economy, Germany, belonged. More likely, however, a government's membership in the Eurozone provided the much-needed justification for unleashing the tremendous surplus funds the banks possessed that would create no profits by simply lying in their vaults.

Besieged as having plunged the world into a financial maelstrom, finance capital was desperate to change the narrative in the aftermath of the financial implosion of 2008. This opportunity emerged with two developments between 2009 and 2010. One was the announcement by Dubai in late 2009 that it could no longer pay the debts it incurred in building its ultra-modern luxury oasis for the global elite in the Persian Gulf. Dubai's default, analyst James Rickards notes, "became contagious, spreading to Europe and Greece in particular".[7] The other event, coming on the heels of the Dubai debacle, was the discovery that Greece, via complex financial deals engineered by the Wall Street firm Goldman Sachs in 2001, had fudged its debt and deficit figures in order keep within the strict rules for Eurozone membership.

Greece's debt in 2007, before the financial crisis, amounted to 290 billion euros, which was equivalent to 107% of its gross domestic product

(GDP). Yet, the banks did not show signs they were particularly worried about it then and continued to pour money into the country. The debt-to-GDP ratio rose to 148% in 2010, bringing the country to the brink of a sovereign debt crisis. Focused on protecting the banks, the European authorities' approach to stabilising Greece's finances was not to penalise the creditors for irresponsible lending but to get citizens to shoulder all the costs of adjustment. Equally important, finance capital and Brussels used Greece's crisis to ram through an assessment that a sovereign debt crisis had also overtaken Ireland, Spain, and Portugal, although these countries had debt-to-GDP ratios that were rather low and, in the case of Spain and Ireland, lower than Germany's.

Sovereign debt is debt that a state is responsible for paying off, whether or not the state took the loan. Ever since the debt crises of the 1980s authorities have enforced the rule that the state must assume responsibility for debt to international creditors that cannot be repaid by its private sector. In his superb book *Austerity*, Mark Blyth writes,

> … sovereign debt crises are almost always 'credit booms gone bust.' They develop in the private sector and end up in the public sector. The causation is clear. Banking bubbles and busts cause sovereign debt crises. Period. To reverse the causation and blame the sovereign for the bond market crisis, as policy makers in Europe have repeatedly done to enable a policy of austerity that isn't working, begs the question, why keep doing it.[8]

Why indeed? The answer is that this operation has promoted a strong counter-narrative about the causes of the financial crisis, where the banks are the victims while states are the villains, a narrative that enables the banks to simultaneously escape haircuts for their irresponsible lending and oppose the imposition of state restraints on their activities.

Painting Greece as America's future

The changed narrative, focusing on the "profligate state" rather than unregulated private finance as the cause of the financial crisis, quickly made its way to the USA, where it was used not only to derail real banking reform but also to prevent the enactment of an effective stimulus programme in 2010. Brandishing the image of the USA becoming like Greece if the government increased its debt load by going into deficit spending, the Republicans succeeded in bringing about a US version of the austerity programmes that were imposed as the solution in Southern Europe.

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Christina Romer, the head of Barack Obama's Council of Economic Advisors, estimated that it would take a $1.8 trillion to reverse the recession.[9] Obama approved only less than half, or $787 billion, placating the Republican opposition but preventing an early recovery. Thus the cost of the follies of Wall Street fell not on banks but on ordinary Americans, with the unemployed reaching nearly 10% of the workforce in 2011 and youth unemployment reaching over 20%.

While weak, the Obama stimulus, coupled with aggressive monetary loosening by the Federal Reserve, prevented the economic situation from getting worse, but the recovery of the next few years was extremely fragile. Moreover, Wall Street's hijacking of the crisis discourse convinced some sectors of the population that it was the Obama Administration's pallid Keynesian policies that were responsible for the continuing stagnation.

Why Wall Street won

The triumph of Wall Street in reversing the popular surge against it following the outbreak of the financial crisis was evident in the run-up to the 2016 presidential elections. The US statistics were clear: 95% of income gains from 2009 to 2012 went to the top 1%; median income was $4,000 lower in 2014 than in 2000; concentration of financial assets increased after 2009, with the four largest banks owning assets that came to nearly 50% of GDP. Yet regulating Wall Street was not an issue in the Republican primary debates while in the Democratic debates, it was a side issue, despite the efforts of candidate Bernie Sanders to make it the centre-piece.

In sum, looking back at the evolution of the financial crisis over the last eight years, one can say that finance capital successfully staved off popularly backed efforts on the part of the state to effectively regulate them by resorting to three strategies.

One was blackmail. Basically, Wall Street and its allies in government successfully sold the line to Congress that they were too big to fail, that is, allowing any one of them to go under would bring down the whole global financial system.

Second, by activating its well-entrenched structural power, through massive lobbying of Congress and mobilising its allies in the Executive, Wall Street was able to prevent the Frank–Dodd financial reform act from containing provisions that would effectively control its most dangerous speculative operations.

Third, finance capital successfully deployed the ascendant neoliberal ideology to shift the discourse on the causes of the crisis from a populist one centred on the greed of banks to a neoliberal one focused on "fiscal irresponsibility" on the part of the state. The US fiscal situation, the banks and neoliberals argue, was simply that of Greece writ large.

The political institutions of one of the world's most advanced liberal democracies were no match for the structural power and ideological resources of the financial establishment. As Cornelia Woll writes, "For the administration and Congress, the main lesson from the financial crisis in 2008 and 2009 was that they had only very limited means to pressure the financial industry into behavior that appeared urgently necessary for the survival of the entire sector and the economy as a whole".[10]

Finance capital puts down a popular uprising

The US case is an example of how finance capital has been able to fend off efforts on the part of the state to exercise effective regulation of its most volatile and dangerous speculative activities, despite massive anger at the banks. In Europe, finance capital showed its most ugly face, where it harnessed the power of the state – indeed, the collective power of 18 Eurozone states led by Germany – to crush peoples' efforts to control their economic destiny.

More than in the so-called liberal market economies of the USA and UK, the relationships among the state, finance, and industry are exceedingly close in Germany, France, and other European economies that political analysts call "coordinated market economies".[11] Technocrats, bankers, and industrialists have powerful interwoven interests, with the state prioritising the interests of the financial sector. Thus, it is not surprising that the German government took a leading role in promoting the interests of German finance capital during the struggle between Greece and its creditors. Behind the troika, of the European Central Bank (ECB), the European Commission (EC), and the International Monetary Fund (IMF) that were formally negotiating with the Greeks, lay the power of the German state, which was principally concerned with salvaging the German banks that had loaned billions of euros to the Greek government and Greek banks.

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The conflict between Greece and its creditors finally came to the boil in 2015, when the Troika sought to blackmail Greece into accepting a deal whereby it would get 86 billion euros in return for a set of draconian measures that included deeper wage cuts, bigger pension cuts, more layoffs in government offices, and more cutbacks in government services. The conditions were imposed on an economy that was already in depression. The GDP fell by 25% between 2008 and 2015, one million jobs were lost between 2008 and 2013, unemployment stood at 26% in 2015, with youth unemployment at a mind-numbing 52%. It was clear even to the IMF that the conditions of the new bailout would kill off any rise in domestic demand necessary for the economy to grow. One IMF analysis admitted that the Fund had not anticipated the extent of the damage wrought by the austerity straitjacket in which the country has been placed since 2010. Another confidential memo acknowledged that what Greece needed most of all was not more austerity but debt relief.[12]

It was, moreover, clear that the 86 billion euro bailout for Greece would be of little help since practically all of it – some 90%, by some estimates – would find its way back to the country's key creditors (the ECB, the IMF and German and French banks) as debt service or for recapitalising Greek banks.[13] Even President Obama had weighed in and called the Eurozone demands untenable: "You cannot keep on squeezing countries that are in the midst of depression...At some point there has to be a growth strategy in order for them to pay off their debts to eliminate some of their deficits".[14]

Given these dire prospects, it is not surprising that the negotiations with the Eurozone countries ended with a Greek revolt, when Prime Minister Alexis Tsipras called in June 2015 for a referendum on the bailout in which over 60% of the Greek people rejected the deal. But in a slap at the democratic will of the badly battered Greeks, the German government, acting to protect the interests of German and European finance capital, warned that it would add further conditions, forcing Tsipras back to the negotiating table. Tsipras, knowing that while the electorate rejected the deal, they would not support a withdrawal from the euro, which would have resulted from rejecting the Eurozone offer was forced into a humiliating surrender.

The tumultuous relationship between the Eurozone authorities and the people of Greece, noted one observer, reflected the "determination to insulate policy from any democratic deliberation".[15]

> It was, at best, an infantilization of the Greek people at the hands of Europe's and Greece's own political elite: until citizens were mature enough to support actions to which there was "no alternative," the correct choice would be made for them. This attitude – not so much the primacy of politics over markets as the dominance of technocracy over democracy – would define relations between Greece and the Eurozone...[16]

That democracy was the ultimate casualty of the Eurozone-Greece face-off was also the opinion of the *Financial Times* columnist, Wolfgang Munchau:

> By forcing Alexis Tsipras into a humiliating defeat, Greece's creditors have done a lot more than bring about regime change in Greece or endanger its relations with the Eurozone. They have destroyed the Eurozone as we know it and demolished the idea of a monetary union as a step towards a democratic political union. In doing so they reverted to the nationalist European power struggles of the 19th and early 20th century. They demoted the Eurozone into a toxic fixed exchange-rate system, with a shared single currency, run in the interests of Germany, held together by the threat of absolute destitution for those who challenge the prevailing order. The best thing that can be said of the weekend is the brutal honesty of those perpetrating this regime change.[17]

Why the German-led Eurozone imposed a Carthaginian peace on Greece will long be discussed, but it is clear that key motives were to save the European financial elite from the consequences of their irresponsible policies, enforcing the iron principle of full debt repayment, and crucifying Greece to dissuade others, such as the Spaniards, Irish, and Portuguese, from revolting against debt slavery. As Karl Otto Pöhl, a former head of Germany's Bundesbank, admitted some time back, the draconian exercise in Greece was about "protecting German banks, but especially the French banks, from debt write-offs".[18]

The subjugation of the Greeks is the latest victory notched up by finance capital since it began its scorched-earth counter-offensive against forces seeking to constrain and regulate it for bringing about the financial crisis that broke in 2008. Yet, its victory is likely to be Pyrrhic, an extremely costly affair that is likely to lead to a greater disaster.

Democracy and finance

In October 2015, Iceland's judicial system sent the heads of the country's biggest banks to jail, along with 23 of their lieutenants. The sentencing was the culmination of a process in which Iceland took a different course from the USA and the rest of Europe. It let the banks go under instead of bailing them out as "too big to fail". It did engage in bailout operations but these were to rescue ordinary citizens rather than bankers, forgiving mortgage debts that went above 110% of the actual value of the home linked to the loan.[19]

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The economy of Iceland did not collapse when its biggest banks were allowed to fail. As one article pointed out,

> Iceland returned to economic growth much faster than skeptics expected after breaking from the conciliatory approach toward financial industry actors that most countries took in the wake of the global collapse. The tiny economy's growth rate outpaced the average for European countries in 2012. It halved its unemployment rate since the peak of the crisis.[20]

What happened in Iceland commanded attention because it was a contrast to what happened elsewhere. That the country was able to tame the finance industry was perhaps due to several factors. One was the relatively small scale of its democracy. With a population of only 329,000 people, most of them in the capital city, Reykjavik, Iceland's elected officials were susceptible to very direct pressure from the electorate, many of whom had suffered massive losses. Another is that with finance having emerged relatively recently as the main driver of the economy, the financial elite had not achieved the massive structural and ideological power that finance capital had achieved in the USA, the UK and the rest of Europe.

Iceland pointed to the possibilities of democratic control of the banks. But it was the exception to the rule. Elsewhere finance capital got off scot-free.

This is not only unjust and tragic. It is dangerous. Advocates for democratic control of finance have an urgent task of mobilising the people, since without effective regulation the chances of another big financial crisis are exceedingly great.

The combination of deep austerity-induced recession or stagnation that grips much of Europe and the USA and the absence of financial reform is deadly. The prolonged stagnation and the prospect of deflation have discouraged investment in the real economy to expand goods and services. Thus the financial institutions have all the more reason to do what they did prior to 2008 that triggered the current crisis: engage in intense speculative operations designed to make super-profits from the difference between the inflated price of assets and derivatives based on assets and the real value of these assets before the law of gravity causes the inevitable crash.

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With the move to reregulate finance halted, the creation of new bubbles is more than likely, what with derivatives trading continuing unabated owing to the lack of effective regulation. The non-transparent derivatives market is now estimated to total $707 trillion, or significantly higher than the $548 billion in 2008, according to analyst Jenny Walsh. "The market has grown so unfathomably vast, the global economy is at risk of massive damage should even a small percentage of contracts go sour. Its size and potential influence are difficult just to comprehend, let alone assess."[21] Former US Securities and Exchange Commission Chairman Arthur Levitt, the former chairman of the SEC, agreed, telling one writer that none of the post-2008 reforms has "significantly diminished the likelihood of financial crises".[22]

With the interests of finance capital now the driving force of the big Western democracies, and virtually unchecked, the question then is not if another bubble will burst but when.

Then the next question is, will it take this coming crisis to finally achieve what the reaction of the 2008 financial crisis failed to do – place finance capital under restraints? In his classic book *The Great Transformation,* Karl Polanyi talked about the "double movement" whereby the excesses of capital create a counter-movement among the people, which forces the state to restrain and regulate it.[23] The failure of the current institutional arrangements of liberal democracy to promote the counter-movement in the aftermath of the 2008 crisis probably means that the next crisis might trigger no less than a fundamental institutional reconfiguration of society's relation to finance capital, indeed, to Capital itself.

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