ephemera | forum
theory & politics in organization

ISSN 1473-2866
www.ephemeraweb.org
volume 9(4): 357-362

Homemade financial crisis

Dick Bryan and Michael Rafferty

There have been many financial crises in the past 30 years. This time it was going to be momentous. Housing foreclosures, bank insolvency and job losses were being compared with, and judged to be even worse than, the great depression (Roubini, 2008; Eichengreen and O'Rourke, 2009). Then there were state bailouts on an unimagined scale. It all signalled that this was no ordinary "crisis". But, even more surprising, market watchers then discerned the turning point (in terms of a slowing in the rate of worsening) and proclaimed a recovery is nigh. A decline in the rate of decline was sufficient to pronounce "green shoots", and since then the graphs of asset prices and business aspirations all pointed upwards.

It is difficult to make sense of an economic environment which has seen asset prices crash then, in the midst of a recession, grow relentlessly. Moreover, there cannot be precluded a "second slump", to use Mandel's term of the 1970s. In the context of this grand spectacle, we have seen in popular debate explanation tied closely to policy resolution. It seems that the point is not to interpret the crisis in various ways, but to fix it. The effect, of course, is that explanation gravitates to the language of failure (that which can be rectified in policy) and policy looks only to points of failure. Possibilities of understanding change – new processes and meanings outside the realm of policy – become (remain) marginalized.

The objective of this paper is to re-focus explanation away from issues of failure and rectification, and towards issues of change; specifically the change that underlay the mortgage-backed securities market, which was, in key respects, the site where the crisis ignited.

There is a simple, populist explanation for the crisis. The initial boom was a speculative bubble, the 2007 crash was a speculative crash and the new resurgence is a speculative bubble, which may well itself burst. Add to that a depiction of retail financial illiteracy and incomprehensible complexity of wholesale products, and we have the recipe for market processes that can go in any direction, en masse and quickly. It is an explanation compatible with whatever happens, so it offers description, laced with moralism, but explains nothing. Add also to that a regulatory reform agenda built on punishing the wicked and promoting financial literacy and market transparency, and we have reforms that fix everything, yet change nothing.

Nonetheless, the populist explanation has clear traction in popular debate, for despite its extravagant condemnation of distortion, it is predicated on the pursuit of "normalcy", conceived as a modest, stable financial system devoid of a speculative momentum and so running at the service of "production". The re-assertion of "normalcy" seems to deny the meaning of a crisis – any crisis – for implicit is the possibility, not just the desirability, of going back to that which "worked". Normalcy is being cast as re-discovering the wisdom of a "regulated" market, even as a new Bretton-Woods-style agreement, but without due recognition that these aspired-to policy regimes were themselves the incubators of crisis.

Our global political leaders seem to be joining this populist chorus. From amongst their number there have been forthright attacks on executive salaries. Further, we have seen President Sarkozy of France (BBC News, 2009) and Lord Turner (2009), head of the British Financial Services Authority, propose the implementation of a Tobin tax: a tax on all financial transactions, designed to discourage "speculation", and a standard demand of every anti-globalization NGO. We have seen the G20 in Pittsburgh in September 2009 espousing populist-sounding sentiments. President Obama (2009), in closing the session, could proclaim on behalf of 19 other heads of state:

> We agreed to take concrete steps to move forward with tough, new financial regulations so that crises like this can never happen again. Never again should we let the schemes of a reckless few put the world's financial system – and our people's well-being – at risk. Those who abuse the system must be held accountable. Those who act irresponsibly must not count on taxpayer dollars. Those days are over. That's why we've agreed on a strong set of reforms. We will bring more transparency to the derivatives market. And we will strengthen national capital standards, so that banks can withstand losses and pay for their own risks. We will create more powerful tools to hold large global financial firms accountable, and orderly procedures to manage failures without burdening taxpayers. And we will tie executive pay to long-term performance, so that sound decisions are rewarded instead of short-term greed. In short, our financial system will be far different and more secure than the one that failed so dramatically last year.

The cynics will no doubt proclaim this as mere talk that will amount to nought. Possibly. Whilst bankers protest the sentiments to be excessive, none of them really wants to return to the world of 2007 where credit ratings could not be relied upon and their credit default swaps would be disavowed. And the banks do, no doubt, like the feeling of the safety net that the states slid under them as they were in free-fall.

A solution package therefore presents itself. Markets are racing back to "normal" and regulatory reform, whilst still to be elaborated, will slay this thing called "neo-liberalism" and rebuild the popular legitimacy of financial markets.

But critical issues have been left out, and central amongst them is the role of workers and households in the financial crisis. On this issue, the moral hazard question provides a point of entry: the long-established economic proposition that bailouts of any sort discourage prudent behaviour in the future. We entered the 2007 crisis not really knowing whether states would bail out big banks: central banks remain intentionally enigmatic on this issue. Fairly soon we had an answer, and an answer that sets a precedent.

In debate around the global financial crisis there has been plenty of discussion of moral hazard. But it has widely mutated into the "too big to fail" question. Financial institution mergers in the wake of the crisis – indeed arranged as a state response to bank crashes – have simply loaded the systemic risk associated with any single bank failure. The problem itself is not new: the policy history of mergers always hits the dilemma that the strong devouring the weak is an expression of competition, but that competitive process is thought to create an anti-competitive outcome. But the conversion of moral hazard into "too big to fail" has also created its opposite: a category of "too small to bail" (Cox, 2009) and that such "institutions" will indeed be permitted to fail. Amongst those too small to bail are the smaller, generally retail banks, and households, whose financial insolvency in the crisis may see them unemployed and homeless, but not a systemic risk to the financial system.

Unlike the smaller banks, whose prudence and profitability over the past 2 years has significantly exceeded that of the "big banks" (Cox, 2009), households have been key players in the financial crisis: it is they, by failure to meet mortgage repayments, who brought the global financial system crashing down. Households may not be "too big to fail" individually, and they were and are never likely recipients of bailouts. But the collective capacity to create a global crisis does signal that something is changed about the position of households in relation to finance.

The conventional image of households is as consumers of finance, but sitting outside of finance. They are cast as either savers, who deposit money in banks in return for interest payments and/or borrowers, who get approval to spend more than is in their account, and in return pay interest. The implicit image here of the financial institution, as redistributors of savings, making profits simply from interest rate spreads, has long been outmoded, yet there is the propensity to retain the complementary image of the consumer. It depicts the household-as-consumer as passive and individualised: the saver; the requester of credit; receiver or payer of interest; the purchaser of financial advice and other services. And the state's response to the crisis seeks to reinforce this passivity. The regulatory reform agenda is addressing households via programs of "financial literacy" and "consumer advice", in the understanding that households have over-reached their capacities, and in the hope that enlightened borrowers will, with assistance, learn to resist their personal devil (greed) and their personal curse (gullibility). Conversely, capital is regulated on the premise of its power: that financial institutions are savvy and scheming and always in control of financial relations with households. They are regulated not to secure modesty, but to contain excessive ambition. Even though this image was found wanting in the financial crisis, new regulatory agendas appear to be leaving it unchallenged.

But the conventional image of households, and the policies which complement that image, are passé. Not only are we seeing the composition and organization of households change in response to financial pressures (e.g. Warren and Tyagi, 2003), but households are now integral to the operation of global financial markets.

Specifically in the context of the recent financial crisis, we should recall the massive growth of mortgage-backed securities and other household-based CDOs did not arise because households overreached. They arose because of the insatiable financial market demand for securitized mortgages, associated with the build-up of global savings and investor desire to invest those savings in US assets. Household lending was the direct consequence of the dispersal of this accumulation. Accordingly, households were not simply borrowers of credit; they were also suppliers of "product" to the securities markets.

In 2005, Ben Bernanke (2005), then a mere Governor of the Federal Reserve, explained it in terms of the US current account deficit being a product of a global savings glut, not US profligacy:

> Following the 1997-98 financial crisis, many of the East Asian countries seeking to stimulate their exports had high domestic rates of saving and, relative to historical norms, depressed levels of domestic capital investment – also consistent, of course, with strengthened current accounts. In practice, these countries increased reserves through the expedient of issuing debt to their citizens, thereby mobilizing domestic saving, and then using the proceeds to buy U.S. Treasury securities and other assets.

The term "and other assets" says it all, for we know now that increasingly the investment of the glut of savings was shifting from low-yielding US Treasury securities to higher-yielding assets (Borio et al., 2008). Central amongst these preferred asset classes were CDOs based on American consumer credit; especially mortgage-backed securities. Bernanke further added:

> A second issue concerns the uses of international credit in the United States and other industrial countries with external deficits. Because investment by businesses in equipment and structures has been relatively low in recent years (for cyclical and other reasons) and because the tax and financial systems in the United States and many other countries are designed to promote homeownership, much of the recent capital inflow into the developed world has shown up in higher rates of home construction and in higher home prices.

The managers of the global surpluses that were used to purchase household-based CDOs were not looking to purchase government bonds, or corporate equities, or derivative positions on commodities; they wanted assets with different risk profiles, and they wanted lots of product. The growth of mortgages was integral to the risk diversification of global financial markets, and in this sense households are not just borrowers (with all the implications of subservience and compliance): they were in demand as objects of investment, just as the steel industry or the wheat harvest are objects of investment. As objects of investment, households are (at least potentially) empowered. Policy agendas of financial literacy and consumer protection effectively seek to suppress consciousness of such empowerment.

What needs to be re-thought, for liberal reformers of consumer protection as well as for visions of social change, is the way in which finance has inserted itself into households, and the role households increasingly play in financial markets. Households are not merely consumers of finance, but are themselves producers and traders of financial products. Here, an emergent politics of financialization awaits. Meanwhile, a depiction of households in financial markets as passive consumers continues to create profit opportunities based on household disempowerment.

The substance of this contradiction is that there is a continual slide between households being consumers and investors, workers and accumulators. The slide is one of analytical slippage, but it is also a statement of intentional ambiguity, for central to the scale and profitability of mortgage-backed security issuance, and an on-going source of financial profit, is arbitraging between households being worker/consumers and investor/accumulators. At the heart of the structure of a mortgage-backed security was the expectation that households would keep paying mortgages so long as the value of the house grew faster than the value of the mortgage. For that to be the behavioural strategy, a house had to be treated by the borrower as an illiquid asset: something to stick with as long as possible. Yet the securities markets needed to treat exposure to the performance of home loans (securities) as a highly liquid asset. It is the "gap" between illiquidity and liquidity that was the basis of households' particular role in global financial markets, as something different from investments in steel industry equities and wheat futures.

The mortgage-backed securities market represents a new agenda in the opening up of the household as a frontier of accumulation. It's not that lending to households is new, nor even that predatory practices are new, even on a large scale (hire-purchase agreements grew massively after World War II). What has changed is the way in which the household is being re-conceived in its relation to accumulation. Finance, having fashioned itself in the discourse of risk management, now looks at households in new ways. Jacob Hacker (2006) has described *The Great Risk Shift*, which captures well many of the processes here, although for Hacker there is simply a redistribution of risks from states and corporations to households and consumers. We are presenting a process that does not simply shift risk, but re-constitutes households in their form and roles as the products of the risk-shifting agenda. Martin (2002) refers to it as the financialization of daily life.

In finance, liquidity is everything – the capacity to buy and sell a range of risks as soon as circumstances (including perceptions of circumstances) change is defining. Yet households and workers individually are characterised by illiquidity – the impossibility of abstracting oneself merely to generic constituents. Economically, a household's major assets are their skills (labour power) and their home. Neither is liquid. Labour power risks, such as skill redundancy cannot be sold off (except via indenturing labour!). Although houses can be sold, they are acquired for reasons of security and stability – as places to live, with personal attachment; not simply as wealth-accumulating assets. To extrapolate, for the sake of brevity, we can see that households are being reconfigured in the eyes of finance as sites of accumulation. The household changes from a sanctuary from accumulation into an advanced site of accumulation.

The sub-prime crisis may have led to the collapse of mortgage-backed securities, which in turn led to defaults on credit swaps, which in turn led to a liquidity freeze, and these latter issues draw the focus of state reform agendas. But its wider social meaning, which is not being addressed in pronouncements of regulatory reform, is the changing position of households, and the unsustainable way in which households are being cast as sources of risk-shifting. This is a systemic process, which will not be addressed by policies of consumer protection, financial market transparency, or financial literacy. Indeed, once the financial literacy campaigns have been rolled out, and households are deemed to have no excuses for being financially gullible, the subsequent stage of financial reform must involve poor laws and the building of workhouses, for how does a state bail out a failed and destitute (but financially-trained and consumer-protected) borrower without creating moral hazard?

references

BBC News (2009) 'Sarkozy to press for 'Tobin Tax''. 19 September. [http://news.bbc.co.uk/2/hi/8264774.stm].

Bernanke, B.S. (2005) 'The global saving glut and the U.S. current account deficit', Sandridge Lecture, Virginia Association of Economics, Richmond, Virginia, 10 March. [http://www.federalreserve.gov/boarddocs/speeches/2005/200503102/#f4].

Borio, C. G. Galati and A. Heath (2008) 'FX reserve management: trends and challenges', *BIS Papers No 40*. Bank for International Settlements, May. [http://www.bis.org/publ/bppdf/bispap40.pdf]

Cox, R. (2009) 'Too small to bail has a nice ring to it', *New York Times*, 28 September. [http://www.nytimes.com/2009/09/29/business/29views.html].

Eichengreen, B. and K. O'Rourke (2009) 'A tale of two depressions', *Vox*. 1 September. [http://www.voxeu.org/index.php?q=node/3421].

Hacker, J. (2006) *The Great Risk Shift: The Assault on American Jobs, Families, Health Care, and Retirement - And How You Can Fight Back*. Oxford: OUP.

Martin, R. (2002) *The Financialization of Daily Life*. Philadelphia: Temple University Press.

Obama, B. (2009) 'Remarks at G20 closing press conference', Pittsburgh Convention Center, Pittsburgh, Pennsylvania, 25 September. [http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-at-G20-Closing-Press-Conference/]

Roubini, N. (2008) 'The worst financial crisis since the great depression', *Nouriel Roubini's Global EconoMonitor*, 16 September. [http://www.rgemonitor.com/roubini-monitor/253618/the_worst_financial_crisis_since_the_great_depression].

Turner, A. (2009) 'How to tame global finance', *Prospect Magazine.* (162) 27th August. [http://www.prospectmagazine.co.uk/2009/08/how-to-tame-global-finance/]

Warren, E. and A. Warren Tyagi (2003) *The Two Income Trap: Why Middle-Class American Mothers and Fathers are Going Broke*. New York: Basic Books.

the authors

Dick Bryan is professor of Political Economy at the University of Sydney. His research, published predominantly with Michael Rafferty has for a decade focussed on money and on innovation in financial markets, and financial derivatives in particular. This research includes the monograph *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class* (Palgrave 2006). Prevalent issues in current research relate to the evolving role played by labour in financial markets and products.
E-mail: dick.bryan@sydney.edu.au

Michael Rafferty is a Senior Research Analyst at the Workplace Research Centre at the University of Sydney. He work focuses on money and finance and the finance industry. As well as work with Dick Bryan on derivatives, he currently works on the performance of superannuation (pension) funds and on issues of capital stewardship. His publications include the monograph *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class* (Palgrave 2006).
Email: michael.rafferty@sydney.edu.au