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The economic crisis

Robin Ramsay

The economic crisis is so large a subject all that I can do is present snippets which I found interesting.

It's the way he tells them

Rory Bremner:[1]

> 'One of the more ludicrous pieces of revisionism is the attempt to blame the regulators for not preventing the crisis. True, our FSA could have done more to see the bubble expanding, but the whole point about regulation under successive chancellors since the Big Bang in 1986 was that the City asked for lighter and lighter supervision – and boy, did it get it. It was part of the Faustian pact that got New Labour into power in the first place. ("What you in the City have done for financial services," enthused Gordon Brown in 2002, "we as a government intend to do for the economy as a whole." He got that right.)' [2]

City lobbying

How this has been achieved, and how the ongoing relationship between the City and government works, is

1 For non British readers, Bremner is one of our leading comedians and impressionists. Unusually, he is politically literate and a lefty.

2 'Bankers complain, but their party goes on', *Daily Telegraph* 22 Jan 2010

suggested in an interesting study, *An Inside Job: A snapshot of political schmoozing by the City,* which describes in some detail the lobbying efforts by City firms and PR companies hired by City firms.[3]

Lobbying by the financial sector was also the subject of *Daily Telegraph* economics editor Edmund Conway's piece on the Davos meeting, which included this:

> '....a recent paper by Atif Mian, Amir Sufi and Francesco Trebbi of the University of Chicago has shown that, on a series of measures designed to clean up after the financial crisis, those US politicians who received greater contributions from the financial services industry were statistically more likely to vote for legislation that transferred wealth from taxpayers to bankers.'[4]

All together now: *no shit, Sherlock!*

Bank of England official says: 'Too big to fail' produces 'the doom loop'

> 'These five strategies are the latest incarnation of efforts by the banking system to boost shareholder returns and, whether by accident or design, game the state. For the authorities, it poses a dilemma. Ex-ante, they may well say "never again". But the ex-post costs of crisis mean such a statement lacks credibility. Knowing this, the rational response by market participants is to double their bets. This adds to the cost of future crises. And the larger these costs, the lower the credibility of "never again" announcements. *This is a doom loop***.**' (emphasis

3 <www.spinwatch.org.uk/images/an%20inside%20job.pdf>

4 'Davos 2010: How to buy friends and influence people', *Daily Telegraph* 28 Jan 2010.

added)[5]

The uselessness of our political systems

In America....

> 'It was sadly clear that the Financial Crisis Inquiry Committee has no clear idea what constitutes bank risk from their questions, or banking for that matter, and the CEOs are dancing rings around them.....It was almost embarrassing to watch this discourse, questions without content to back them, so lacking in probing value.' [6]

At least the Americans are having an inquiry. In this country:

> 'Still no inquiry. Still no answers. A trillion pounds has been devoted over the past 18 months to protect Britain's financial system from alleged Armageddon, with not a murmur of value for money. This stupefying sum is more than has ever been spent on any project by any government in British history.
>
> We know where the money came from but we do not know if it was necessary, nor who now has it. We know only that, a year on, Britain is experiencing a worse recession than any comparable country. The lack of accountability, the sheer lack of curiosity from the political community, is amazing.' [7]

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5 Piergiorgio Alessandri and Andrew G Haldane, 'Banking on the state' Bank of England, November 2009. Haldane is Executive Director, Financial Stability, Bank of England.

6 Nomi Prins, 'Why Can't We Get Anyone to Ask a Wall Street CEO the Hard Questions?' <www.truthout.org/nomi-prins-why-cant-we-get-anyone-ask-a-wall-street-ceo-hard-questions56070>

The committee was appointed by President Obama 'to examine the causes, domestic and global, of the current financial and economic crisis in the United States.'

7 Simon Jenkins 'The bankers lied. And Darling, a mere puppet on their string, knows it.' *The Guardian*, 11 March 2010.

Greek Debt Crisis

> 'Goldman Sachs helped the Greek government to mask the true extent of its deficit with the help of a derivatives deal that legally circumvented the EU Maastricht deficit rules. At some point the so-called cross currency swaps will mature, and swell the country's already bloated deficit.' [8]

All together now: *you couldn't make this stuff up!*

The words on the 'Street' [9]

> 'But there is no question that politicians either believed that crazy "financial engineering" created a sound basis for sustainable growth or just loved what the financial system could do for them at election time.
>
> And, as Sorkin[10] relates, it is hard to escape the conclusion that the rhetoric regarding our supposedly free markets without government intervention just masks the reality – that there is a revolving door between Wall Street and Washington, and powerful people bend the rules to help each other out. In an illustration of Wall Street clubbiness, Sorkin documents a meeting in Moscow between Hank Paulson, secretary of the treasury (and former head of Goldman Sachs), and the board of Goldman Sachs. As the storm clouds gathered at the end of June 2008, Paulson spent an evening talking substance with the board – while agreeing not to record this "social" meeting in his official

8 Beat Balzli, 'How Goldman Sachs Helped Greece to Mask its True Debt' , *Der Spiegel,* 8 February 2010, <www.spiegel.de/international/europe/0,1518,676634,00.html 02/08/2010>.
9 Sunday, December 27, 2009 <www.washingtonpost.com/wp-dyn/content/article/2009/12/23/AR2009122301670.html>.
10 Author of *Too Big Too Fail*, discussed later in this section.

calendar. We do not know the content of the conversation, but the appearance of this kind of exclusive interaction shows how little our top officials care about public perceptions of favoritism.

In saner times, this would constitute a major scandal. At moments of deep crisis, understanding what influences policymakers and having access to them can help a firm survive on advantageous terms. Goldman Sachs was saved, in large part, by suddenly being allowed to become a bank holding company on Sept. 21, 2008. Our most senior government officials determined that the United States must allow Goldman to keep its risky portfolio of assets, while offering it essentially unfettered access to cheap credit from the Federal Reserve. In rescuing a crippled investment bank, the Treasury created the world's largest government-backed hedge fund.'

Oh! Our lovely British bankers

'America's top bankers quashed attempts by their British counterparts to persuade the industry to bring down salaries in response to public outrage after the world's governments spent billions rescuing the system.

Chief executives from the world's banks discussed the plans at a secret dinner held at Claridge's, the London hotel, last October, at which several leading British bankers are said to have suggested that the sector should take greater responsibility for its part in the crash, and do more to reduce the vast bonuses paid to staff.

But the recommendations were met by stiff opposition from the US banks JP Morgan, Morgan Stanley and Goldman Sachs, according to one source:

> "Some of the US bankers were furious about attempts to reduce pay throughout the industry, arguing that any such move smacked of socialism and would be fiercely resisted," the source said on Friday. "It's not the way the Americans like to go about their business."' [11]

This story might be true but might simply be PR on behalf of the British bankers.

Books on the crisis

There are now a large number of books about the crisis. I have tried three of them. Andrew Ross Sorkin's 550 page *Too Big Too Fail* (London: Allen Lane, 2009) is a blow by blow account of the events during the days when a total crash seemed possible. Yes, blow by blow – minute by minute in some instances – but also (oddly, really) rather dull and in need of a major edit. Sorkin's style is to chuck in all manner of extraneous detail – who was wearing/eating/driving what; writerly colour – which I guess is meant to make a fairly dry text more palatable In practice it just provides sections which I found myself skipping. A much bigger fault is a simple technical mistake. Sorkin is dealing with a very large number of actors in this story and he provides a 'cast of characters' at the beginning of the book. However, instead of making it a simple alphabetical list, he divides them up into the firms and institutions they worked for. The result is that if you come across a name you cannot remember and turn to the front of the book, you have eight pages of names to plough through. In the end, despite Sorkin's efforts, in a sea of names I couldn't keep track of, I gave up half way through.

Gillian Tett's *Fool's Gold* (London: Little Brown, 2009) is much better, and not just because it is 200 pages shorter. Tett is a *Financial Times* journalist who smelled a rat about the

11 Margareta Pagano, 'US banks veto "socialist pay" in secret talks', *The Independent on Sunday* 28 February 2010.

extraordinary growth in bank assets and profits in 2006 and began researching the subject. Tett tells the story of how the system got into the mess it did, tracing the crisis forwards from deregulation in the 1990s. Where Sorkin is not much more than a groupie at times, Tett has a slight critical edge. Tett focuses on the role played in the meltdown by a group of 'financial innovators', working for JP Morgan, looking for ways round the restrictions on the formation of bank credit set by the world's financial regulators. But Morgan was not quite as greedy as some of the other banks, did not engage in quite the same risk-taking behaviour, and thus came out of the crisis smelling like roses. By showing the big events through the eyes of the Morgan group she anchors a lot of complex narrative round one viewpoint; and this makes it easier to follow. She has a nice clear, simple style. Of course she presents far too rosy a picture of JP Morgan: they may not have been sharks in the manner of the other banks but sharks they were nonetheless, as Matt Taibbi's essay in *Rolling Stone*, 'Looting Main Street', discussed below, demonstrates.

The best of the three books is John Lanchester's *IOU* (London: Simon and Schuster, 2009). Lanchester is neither banker nor financial journalist and his understanding of the crisis has been acquired by study and research; and he is thus able to communicate some of this complicated technical stuff to the lay reader. Lanchester also writes clearly and well and has the advantage of a serious critical edge: his familiarity with this material has not stifled his sense of outrage and incredulity at the things the bankers have been allowed to get away with.

Lanchester is very good but the best writing to date on these events is by Matt Taibbi in *Rolling Stone*. If he writes a book, that would be the one to get. In the meantime his essays in *Rolling Stone* are on-line. In one of those essays he portrays the Wall Street post-crash bailout by the US government in some of the terms of conmen and grifter strategies. This is a quite brilliant idea which works wonderfully well.[12] A more recent essay of his includes this section which conveys the man's style (and bile):

> 'The question everyone should be asking, as one bailout recipient after another posts massive profits — Goldman reported $13.4 billion in profits last year, after paying out that $16.2 billion in bonuses and compensation — is this: In an economy as horrible as ours, with every factory town between New York and Los Angeles looking like those hollowed-out ghost ships we see on History Channel documentaries like Shipwrecks of the Great Lakes, where in the hell did Wall Street's eye-popping profits come from, exactly? Did Goldman go from bailout city to $13.4 billion in the black because, as Blankfein suggests, its "performance" was just that awesome? A year and a half after they were minutes away from bankruptcy, how are these assholes not only back on their feet again, but hauling in bonuses at the same rate they were during the bubble? The answer to that question is basically twofold: They raped the taxpayer, and they raped their clients.' [13]

Fraud Inc

While this issue was being prepared the US SEC announced a lawsuit against Goldman Sachs, essentially for fraud. It is an interesting symbolic step but it is not a criminal complaint, merely a civil one, and will take years to trundle through the courts. But the fact that this step had been taken has been the cue for sections of the financial media to begin describing

12 'Wall Street's Bailout Hustle', *Rolling Stone,* Issue 1099, 4 March 2010.

13 'Looting Main Street: How the nation's biggest banks are ripping off American cities with the same predatory deals that brought down Greece' *Rolling Stone*, issue 1105, April 15, 2010.

the fraudulent activities of Goldman Sachs and other financial institutions. Many other frauds have been identified and not pursued;[14] and the outline of a huge rip-off by a company called Magnetar was just beginning in the US as I wrote this in April.[15] Since when it has become clear that almost everybody was at it.

Is there the political will in the US to do something major? Until recently I would have just written, No, of course not: and not just because the financial speculators have spent tens of millions of dollars in the last year 'lobbying' (i.e. bribing) American politicians to prevent meaningful regulation[16] and the Obama administration is riddled with bankers;[17] but for the same reason that there is no such will in the UK:[18] the political systems cannot see how US inc. or UK plc can survive without Wall Street and the City in something like their present forms. However, in late May the shape of the new regulations which are going through Congress became known and the answer appears to be that while some significant things have been proposed, the key change – outlawing all the financial gambling – has been flunked. We will see when the final bill appears in June or July but for the moment it looks as though the lobbying by Wall Street has paid off and the big gambling systems will continue. This

14 See Marian Wang, 'Other Major Banks Did Deals Similar to Goldman's' < www.propublica.org/ion/blog/item/other-major-banks-did-deals-similar-to-goldmans> and <www.washingtonsblog.com/2010/04/goldman-sacked.html> for a list of already identified frauds that are not being acted on.

15 <www.propublica.org/feature/all-the-magnetar-trade-how-one-hedge-fund-helped-keep-the-housing-bubble>

16 See for example the discussion (text and video) by Johnson and Kwak, authors of *13 Bankers*and the website <www.baselinescenario.com> at <www.pbs.org/moyers/journal/04162010/profile.html>

17 A list of Goldman Sachs personnel involved with the Obama administration is at < http://seminal.firedoglake.com/diary/46267>.

18 Despite the recent flurry of low-level activity by the British FSA. See, for example, Harry Wilson, 'FSA charges seven over "£2.5m insider-trading ring" , *Daily Telegraph*, 31 March 2010.

comment is from the generally excellent Washington's blog:

> 'The Senate passed a financial "reform" bill today by a 59-39 vote which won't fix any of the core problems in the financial system, and won't prevent the next financial crisis.
>
> The bill doesn't include the Volcker Rule (it wasn't even debated), doesn't break up or even substantially rein in the too big to fails, doesn't stop prop trading, and doesn't force transparency in the derivatives market.' [19]

Gordon Brown said just before the election that he wanted a 'new constitution for global banks' (there is one already?); but that this would have to be done globally (i.e. not at all); and he didn't 'want a race to the bottom in banking where some countries set up as offshore havens.' [20] What he meant was: I don't want to see the UK lose its status as the extant offshore haven of choice. Peter Mandelson hinted at this in a speech in the US in March when he said:

> 'Trying to apply sweeping rules about the structure, content and range of banking entities' activities is too difficult to do. It's the principles and practices of regulation you have to focus on, not the size and range of banks.' [21]

Basically, it was a housing bubble

In the midst of all this banking analysis the American writer Dean Baker said, hold on a minute, what really happened to the American economy is that a vast housing bubble, pumped up by the government and the Fed, has burst.

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19 http://georgewashington2.blogspot.com/2010/05/senate-passes-faux-financial-reform.html

20 Louise Armitstead, Gordon Brown: 'I couldn't have stopped Goldman Sachs', *Daily Telegraph*, 19 April 2010.

21 James Quinn, 'Lord Mandelson condemns Volcker rule as too "sweeping"' *Daily Telegraph* 3 March 2010.

> 'For the vast majority of middle-class families, home equity is their financial asset. When the collapse of the bubble resulted in the disappearance of $8 trillion of housing bubble wealth ($110,000 per homeowner on average), tens of millions of homeowners had no choice but to sharply curtail their consumption.
>
> The wealth that homeowners had taken for granted during the bubble years was gone. This meant that these homeowners could no longer borrow against home equity to support their level of consumption and that they would need to hugely increase their savings to rebuild the wealth they had lost. The rapid fall off in consumption, coupled with the collapse of housing construction, guaranteed the onset of a severe recession. There is no simple way to offset the loss of more than $1 trillion in annual demand in the economy – $450 billion in lost housing construction and between $600 billion and $800 billion in lost consumption.'

Baker also says:

> 'Arguably, the Fed even fostered the bubble's growth, seeing it as the only source of dynamism in an economy that was suffering from the aftershocks of the collapse of a $10 trillion stock bubble.' [22]

Now we're getting to it. And the same thing happened here, as the UK followed America. Who says so? Governor of the Bank of England at the time, Eddie George, says so. I reprint here part of what I wrote in *Lobster* 53 (2007) on this subject.

Steady Eddie blows the gaff

We learn from the former Governor of the Bank of England, Lord Edward George, that, faced with the prospect of recession 'at the beginning of the decade', the Bank's Monetary Policy Committee

22 'False Profits: We Will Be Suffering from Greenspan and Bernanke's Ineptitude for a Long Time' at <www.alternet.org/> on 9 February 2010.

(MPC) encouraged house prices and personal debt to rise. Speaking to the House of Commons Treasury Committee, George said:

> 'In the environment of global economic weakness at the beginning of this decade........... external demand was declining and related to that business investment was declining. We only had two alternative ways of sustaining demand and keeping the economy moving forward: one was public spending and the other was consumption..... But we knew that we were having to stimulate consumer spending; we knew we had pushed it up to levels which couldn't possibly be sustained into the medium and long term. But for the time being, if we had not done that the UK economy would have gone into recession just as had the United States. That pushed up house prices, it increased household debt.'

For the same reason – a shrunken manufacturing base – the UK and American governments turned to consumer debt, house price inflation (to 'secure' the debt), imports and their financial sectors to keep their economies rolling. The alternative to the Anglo-American borrow/gamble/deficit/import model of the past 20 years involves rebuilding the countries' manufacturing and this is too complex a project for the political system as presently constructed. (And if it cannot handle this how is it going to handle the conversion to a low carbon economy?)

That the importance of manufacturing for Britain is now being written about again is a welcome change of tack. Here's the *Telegraph* economics editor Edmund Conway:

> 'One dangerous misconception perpetuated by financial lobbyists is that without the City, we are nothing. Financial engineering [sic], they argued, was something Britain was well placed to do, while mechanical engineering could be carried out far more cheaply by the Chinese, or with far greater quality by the Germans. While it is a compelling narrative, and fits nicely with the

British propensity for defeatism, it is balderdash.' [23]

But it is terribly late in the day for the change of view.

> 'Manufacturing accounted for more than 20 per cent of the economy in 1997, when Labour came to power critical of the country having too narrow an industrial base. But by 2007, that share had declined to 12.4 per cent.' [24]

Ten years ago EEF (the Engineering Employers' Federation as was) published a report predicting that without government support for manufacturing,

> 'trade in goods would hit a deficit of almost £80bn by 2010. Ten years on and the deficit stood at £81.9bn in 2009, up from £29bn in 2000 and compared with a surplus of £1.3bn in 1980.'

There is now widespread agreement in this country that we have to rebuild manufacturing.[25] But how do you that in an open world economy, competing with countries such as China which pay their workforce a fraction of this country's?

Chris Mullin was the MP for Sunderland South until this year. In his diary of his time with New Labour, *A View from the Foothills*, there is strikingly little about economics as he dolefully records factories closing in his constituency. In 2002 a Dewhirst plant making clothes for Marks and Spencer is threatened as M and S begin to shift their production overseas. Mullin notes 'at this rate there won't be a single manufacturing job left in Sunderland by the time we leave office.' (p. 255) He has lunch with a local property developer who tells him that the death of manufacturing is inevitable

23 Edmund Conway, 'Shock news – Britain still makes things. Our much-mocked manufacturing sector is stronger than we think', *Daily Telegraph* 26 November 2009.

24 Chris Giles, 'Manufacturing fades under Labour', *Financial Times*, 2 December 2009 <www.ft.com/cms/s/0/f32a3392-df7a-11de-98ca-00144feab49a.html?nclick_check=1>.

25 Gordon Brown has been referring to 'modern manufacturing' for several years, though precisely what that means is not clear.

‘part of an historic cycle which politicians are powerless to reverse.....Peter, dynamic far-sighted businessman that he is, is optimistic that something will turn up.’ (p. 308)

But nothing has turned up, has it?

The only obvious way to do it is by the traditional methods: tariff barriers, import controls and state direction of investment and saving. But these are incompatible with the current international economic rules and the rules of the EU. In my view these changes will have to be made but there are years of economic decline ahead before they are seriously considered by any of our major political parties. Such ideas are just beginning to be heard in the USA on the left fringe of the Democratic Party and eventually they will appear here.[26]

26 See for example Ian Fletcher, ‘ Thinking the Unthinkable: Could America Repeal NAFTA?’ truthout, Tuesday 20 April 2010, <www.truthout.org/thinking-unthinkable-could-america-repeal-nafta58717>