The economic crisis continues

Robin Ramsay

The bottom line (of the bottom line)

At the end of December 2010 Her Majesty's Treasury put out a document which stated:

> '...net debt excluding the temporary effects of financial interventions was £889.1 billion, equivalent to 59.3 per cent of gross domestic product (£2322.7 billion, equivalent to 154.9% including interventions).'[1]

A sum equivalent to almost 100% of this country's annual Gross Domestic Product (GDP) has been 'borrowed' (created, magicked) to bail out the banks. We are going to be paying for the banks for ever. But the underlying borrowing – 'net debt excluding the temporary effects of financial interventions' – is still not significantly greater than other comparable EU economies. On page 127 of the IMF 's 2011 *Fiscal Monitor* is statistical table 7, which lists General Government Gross Debt as a percentage of GDP. The UK figure for 2011 is 83, France 85, Germany 80.[2] The present 'crisis' of government borrowing is about paying for the bankers' fuck-ups.[3]

As the editor of *The Spectator*, Fraser Nelson, said in 2009, the UK is now a bankocracy.

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1 <www.hm-treasury.gov.uk/d/psf.pdf>

2 <www.imf.org/external/pubs/ft/fm/2011/01/pdf/fm1101.pdf> How this figure is reconciled with the different UK Treasury figure I have not tried to ascertain. The Treasury figure will be a fake of some kind, aimed at showing that the UK is still within the EU's 60% of GDP rule; it probably excludes things like PFI contracts.

3 In 'Chinese rating agency downgrades UK debt', *Daily Telegraph* 24 May, the UK figure was given as 82.5pc of GDP.

'It is as if there has been a silent coup d'état – instead of the taxpayers owning the banks, the banks now seem to own the taxpayers. They have been given access to the present and future earnings of the British public, which will plug their mind-blowing losses....What's happening with RBS, B&B, Northern Rock and, soon, Lloyds is what the bankers call a reverse takeover. The scale is mindblowing. RBS's £2 trillion of liabilities dwarfs not only the government reserves but the entire UK economy. Brown hasn't so much nationalised the banks, he has bank-ised the nation.' [4]

Nelson used the term 'bankocracy', which I thought was recent; Anne Pettifor has used it, for example.[5] But then I noticed a letter in the *London Review of Books* pointing out that Marx had used the term in the first volume of *Capital*.[6]

Brown's *mea culpa* (or: we didnae ken)

In April Gordon Brown was at a conference in Bretton Woods in New England and said:

'We set up the FSA believing the problem would come from the failure of an individual institution. That was the big mistake. We didn't understand just how entangled things were.'

Well, that would be one way of looking at it. And he was not alone in not understanding what was going on. Here's a 2006 statement from the IMF which could hardly have been more wrong.

'There is growing recognition that the dispersion of

4 <www.spectator.co.uk/coffeehouse/3358846/the-banks-reverse-takeover-of-britain.thtml>

In each of the UK, Germany, France and Ireland, the combined assets of the three largest banks were greater than national GDP in 2008. See <www.bondpearce.com/5359/Are_banks_too_big_to_fail_in_dominant_position>.

5 Her very good blog is <www.debtonation.org/>

6 <www.lrb.co.uk/v32/n07/letters>

credit risk by banks to a broader and more diverse group of investors, rather than warehousing such risk on their balance sheets, has helped to make the banking and overall financial system more resilient..... the commercial banks, a core segment of the financial system, may be less vulnerable today to credit or economic shocks' potential for market disruptions.' [7]

The idea that 'the dispersion of credit risk' would make the banks 'less vulnerable' was coming from the bankers busy expanding the debt.

But as for Gordon's cry of 'We didnae ken', he and everybody else that mattered were warned. They just didn't want to hear the warnings.

'On April 17, 2007, famed short-seller Jim Chanos and other hedge fund managers met under tight security at the World Bank in Washington for the G-8 meeting. Chanos and Paul Singer briefed prominent policy officials [including Gordon Brown] about the growing financial instability. They gave irrefutable evidence that a catastrophe was building. They told officials that banks were about to sink the global economy. They called for decisive action. And they were ignored.' [8]

The Irish were warned in a series of newspaper articles by an Irish academic economic historian, Morgan Kelly. But Kelly was ignored until it was too late. This is from the Michael Lewis essay 'When Irish Eyes Are Crying':

'In [Colm] McCarthy's[9] view, the dominant narrative inside the head of the average Irish citizen – and his receptiveness to the story Kelly was telling – changed at roughly 10 o'clock in the evening on October 2, 2008. On that night, Ireland's financial regulator, a lifelong Central

7 IMF Global Financial Stability Report, chapter 2: 'The influence of credit derivative and structured credit markets on financial stability'.
8 <www.newdeal20.org/2009/09/01/nd20-exclusive-interview-jim-chanos-warned-brown-geithner-and-others-about-coming-financial-crash-in-2007-and-he-was-ignored-4380/>
9 Lecturer in economics at University College, Dublin.

> Bank bureaucrat in his 60s named Patrick Neary, came live on national television to be interviewed....Now the Irish people finally caught a glimpse of the guy meant to be safeguarding them: the crazy uncle had been sprung from the family cellar. Here he was, on their televisions, insisting that the Irish banks were "resilient" and "more than adequately capitalized".......when everyone in Ireland could see, in the vacant skyscrapers and empty housing developments around them, evidence of bank loans that were not merely bad but insane. "What happened was that everyone in Ireland had the idea that somewhere in Ireland there was a little wise old man who was in charge of the money, and this was the first time they'd ever seen this little man," says McCarthy. "And then they saw him and said, *Who the fuck was that??? Is that the fucking guy who is in charge of the money???* That's when everyone panicked." '[10]

Away from the collapse of the banks, Brown was repeatedly warned by the IMF that he was allowing a housing bubble to be inflated in the UK economy and that the government and its citizens were borrowing too much. In 2003 the IMF warned about government borrowing;[11] in 2005 about the expanding UK personal debt which had then reached £1 trillion;[12] then about government borrowing;[13] the trade deficit,[14] and

10 <www.vanityfair.com/business/features/2011/03/michael-lewis-ireland-201103> Lewis was the author of the classic account of 1980s Wall St. rackets, *Liar's Poker*.

11 BBC News on-line, 19 December, 2003, 'IMF gives Brown borrowing warning'

12 <www.thisismoney.co.uk/credit-and-loans/dealing-with-debt/article.html?in_article_id=403722&in_page_id=62>

13 'Brown besieged over growth and borrowing plans', *The Times*, 22 September 2005

14 20 Dec 2005, 'IMF fires new warning over Britain's finances', <www.orange.mu/kinews/afp/business/107293/imf-fires-new-warning-over-britain-s-finances.html>

repeatedly about the house price bubble.[15] But Brown had spent his entire parliamentary career in a world in which only one economic indicator really mattered: the inflation figure. Managing inflation was the only task given to the Bank of England's Monetary Policy Committee. And from the early 1990s onwards Brown had been educated on his trips to America to accept the 'Washington consensus', one of whose central edicts was that the state should do as little as possible and leave the macro-economy to the market. And so it transpired that while Gordon Brown was nominally in charge of the economy from 1997 onwards, NuLab allowed the manufacturing base to be further diminished by imports (mostly Chinese) and tried to compensate for this loss of economic activity with increased personal and public debt.

Gordon Brown hasn't said much since he quit but he did give an interview to *Der Spiegel.* Here is the key section, which illustrates Brown's picture of the world. The emphases have been added by me.

SPIEGEL: Critics argue that you not only helped solve the crisis, but that you also had a hand in creating it in the first place. In 2005, as Chancellor of the Exchequer, you told managers that government should not only 'have a light touch, but a limited touch' in banking regulation.

Brown: You've got to understand the atmosphere in Britain at the time. We had introduced the Financial Services Authority and had removed the system of self regulation in the City. We had merged all the different supervisory organizations....

SPIEGEL: ....but the result was an extreme dearth of regulation. There is a reason that Lehman Brothers did much of its business in London.

15 In 2005 <www.independent.co.uk/news/business/news/imf-warns-over-uk-property-crash-415925.html>; in 2006 <www.independent.co.uk/news/business/news/imf-warns-over-uk-property-crash-415925.html> and <http://business.timesonline.co.uk/tol/business/economics/article2678215.ece>; and in 2008 <http://business.timesonline.co.uk/tol/business/industry_sectors/construction_and_property/article3677630.ece>

Brown: Lehman Brothers failed to declare its financial position. *You cannot blame the regulator for not picking up something when there was a failure to declare***.** In the end, it wouldn't have mattered whether regulation was a little stronger or a little weaker. What we hadn't factored in was the interdependence between the different financial institutions. What happens to one bank has implications for a lot of others.

SPIEGEL: Regulators in Canada, Australia and Sweden have obviously done a better job. Banking systems in those countries weren't hit nearly as hard. Do you not see any errors at all in hindsight?

Brown: I wish that we had had a better understanding. We did a trans-Atlantic simulation exercise in early 2007 which included US Secretary of the Treasury Hank Paulson and Chairman of the Federal Reserve Ben Bernanke. We looked at what would happen if an individual institution collapsed. People realized that there were consequences that went beyond that individual institution. But we didn't analyze what would happen to the system in its entirety, due to connections and entanglements. We should have built a *global* control system for the financial sector much earlier.

SPIEGEL: Both Germany and the European Union had tried to adopt tougher regulations long before the crisis. *But London always stood in the way.*

Brown: That's a misunderstanding. I was always in favor of intervention but wanted to do it on a *global* level. If you regulate in Europe, but not in America or Hong Kong, Singapore or Switzerland, banks will be basing more of their operations abroad. You need a global system, and that is now recognized. But I see the problem that we're not yet implementing rules at a *global* level that cover all the major financial centers.

SPIEGEL: There will always be someone who doesn't play by the rules. Isn't the call for global supervision just a lazy excuse for doing nothing?

At which point Brown began more evasive manoeuvres.

He has been nailed by the *Spiegel* interviewer, has he not? All this appeal to the global is evasive flimflam. Brown was a supporter of the City's desire for regulatory inactivity (because the status quo benefited London), which he rationalised with the globalisation nonsense. This is a similar psychological mechanism to that which I heard used by the late Ken Coates MEP at a meeting in the 1980s: when confronted with examples of the idiocy and corruption of the EU, Coates replied that he was working towards a united socialist states of Europe. I thought, but was too polite to say, 'Good luck with that one, Ken!'

Independent Commission on Banking

Meanwhile, having narrowly avoided financial armageddon, the government did what British governments always do, it appointed a committee, an 'Independent Commission on Banking', which produced its interim – i.e. open to consultation; i.e. open to watering down by the City – report in April. This was greeted with derision from many quarters. And no wonder: you only had to read the introductory pages to see what was what. The comments in italics are mine.

> 'Banks must have greater loss-absorbing capacity and/or simpler and safer structures. One policy approach would be structural radicalism *(radical: bad thing)* – for example to require retail banking and wholesale and investment banking to be in wholly separate firms.'
>
> *Which would reduce banking profits*
>
> 'Another would be to be laissez-faire about structure and to seek to achieve stability by very high capital requirements across the board.'

Which would reduce banking profits.

'The Commission, however, believes that the most effective approach is likely to be a complementary combination of more moderate *(moderate: good thing)* measures towards loss absorbence and structure.....

In case we hadn't got the message it was repeated a couple of paragraphs later.

'Rather than pursuing more radical (*bad*) policies towards capital or structure, the approach outlined above is a combination of more moderate (*good*) measures.'

'As to the form that separation might take, a balance *(balance: good thing)* must be struck between the benefits to society of making banks safer and the costs (*to the bankers*) that this necessarily entails. Full separation – i.e. into separate entities with restrictions on cross-ownership – might provide the strongest firewall to protect retail banking services from contagion effects of external shocks. But it would lose some benefits of universal banking.'

And what are the 'benefits of universal banking'? They get to gamble with our savings and make a lot money for themselves.

So instead of a 'firewall' they propose a 'ring-fence' (details to follow). This, I imagine, will be about as robust as the 'Chinese walls' erected between sections of banks in the 1980s after 'big bang'.

The banks will not be asked – let alone be legally obliged – to cease the so-called trading (gambling) activities which got them into the mire in the first place, and they will continue. The banks *will* be asked to retain a little more capital but the sums involved will be neither here nor there, entirely incapable of coping with the massive losses when trading (gambling) goes wrong. And even the piffling required increase in retained capital will be partially evaded with a financial device called a co-co or 'contingent convertible', a form of debt which will be issued with the understanding that the bank might need it back if things go wrong.[16]

The red old lady of Threadneedle Street

Meanwhile those notorious radicals at the Bank of England continue with their subversive analyses. Andy Haldane, Executive Director, Financial Stability, has been looking at the history of bubbles and the rise of the financial sector and in a lecture, 'The Contribution of the Financial Sector: Miracle or Mirage?' [17] he made the following comments (the italicised sections in parentheses are mine):

> 'Risk illusion (*gambling*), rather than a productivity miracle, appears to have driven high returns to finance. The recent history of banking appears to be as much mirage as miracle....
>
> Philippon and Reshef (2009) have undertaken a careful study of "excess" wages in the US financial industry since the start of the previous century, relative to a benchmark wage.....This shows a dramatic spike upwards which commenced in the early 1980s, but which exploded from the 1990s onwards. The only equivalent wage spike was in the run-up to the Great Crash in 1929. *Philippon and Reshef attribute both of these wage spikes to financial deregulation*......' (emphasis added)

16 <www.telegraph.co.uk/finance/economics/6584022/What-we-all-ought-to-know-about-co-co.html>

17 <www.bankofengland.co.uk/publications/speeches/2010/speech442.pdf>

> 'Essentially, high returns to finance may have been driven by banks assuming higher risk (*gambling*). Banks' profits, like their contribution to GDP, may have been flattered by the mis-measurement of risk..... this increase in risk was to some extent hidden by the opacity of accounting disclosures (*Enron accounting; lying*) or the complexity of the products involved.....
>
> '.....because banks are in the risk business it should be no surprise that the run-up to crisis was hallmarked by imaginative ways of manufacturing this commodity (*gambling*), with a view to boosting returns to labour and capital. Risk illusion is no accident; it is there by design. It is in bank managers' interest to make mirages seem like miracles.'

Even more striking, the Governor, Mervyn King, in a lecture in October 2010:

> '.....it is hard to see why institutions whose failure cannot be contemplated should be in the private sector in the first place.' [18]

Back to the future: manufacturing

There has been a good deal of talk in and around Westminster on the need to expand the British manufacturing economy. For example:

> 'The UK has been making some progress towards building the foundations of sustainable growth, for which manufacturers can take significant credit. The past four quarters have seen a strong and positive contribution from the UK's industrial sector, where output has been expanding at its fastest pace since the end of

18 'Banking: From Bagehot to Basel, and Back Again': <www.bankofengland.co.uk/publications/speeches/2010/speech455.pdf>

the last economy-wide recession in 1994.' [19]

But nothing has actually been done. This is not surprising. How do the British state and the Conservative Party now decide to build an industrial strategy? Does the British state have people in its upper echelons who believe in the economically active state (except to save bankers)? Its senior figures are too young to remember how an industrial strategy was done before the arrival of Mrs Thatcher. Institutionally the Conservative Party hasn't believed in an industrial strategy since 1979. The John Major government in the 1990s, mainly in the shape of the Chancellor of the Exchequer, Kenneth Clarke, showed glimmers of appreciating the need for one after the pound was forced out of the Exchange Rate Mechanism in 1992, but that government was overwhelmed by the recession it had created trying to stay in the ERM.

In the *Guardian* on 25 April there was an interesting editorial on the economy and the difficulties of an industrial strategy. It claimed that if one talks of such things, 'you get drowned in a wave of fatalism. You cannot beat cheap Chinese competition, runs the argument.' The *Guardian* editorialist then offered this as the prescription:

> 'The government should direct the state-owned banks to lend more at lower rates to key sectors, and give tax relief to firms that produce and employ staff in the UK.'

Which are decent ideas but are not an industrial strategy. They are two of the preconditions of an industrial strategy. And how far away is such a thing when this present regime – and its Labour predecessor – wouldn't dare to 'direct state-owned banks'?

Back to the future (again)

Scott Newton and Peter Cain's 'Crisis and recovery: historical

19 Terry Scuoler, 'Manufacturers can help make Britain a world leader', the *Daily Telegraph* 22 November 2010.

perspectives on the Coalition's economic policies' is a short (3,500 words) sharp account of this government's economic policies by two economic historians who conclude:

> 'What differentiates the present crisis markedly from both of the pre-1945 financial crises we have examined, and from anything that has happened since 1945, is that the coalition is adopting 1920s-style cuts in the context of 1890s and 1930s-style international financial crises... ...... the government is taking a gamble of unprecedented proportions that could result in historically low rates of growth for many years.' [20]

Similar views were expressed by the former member of the Bank of England's Monetary Policy Committee, David 'Danny' Blanchflower, who said in a recent interview:

> 'This Government has not been in office before, has no background in economics and are plunging into something. But the risks are greater than they know. It would be great if they're right and millions of jobs are created and everything is nirvana... but boy, that's what they said in the US in 1937. If you don't learn from the mistakes of history, you simply repeat them.' [21]

Enter the spooks

On 3 February the American magazine *Manufacturing and Technology News* reported:

> 'The Director for National Intelligence is undertaking a National Intelligence Estimate (NIE) on the state of American manufacturing. Growing concern over loss of domestic capability and dependence on foreign nations

20 <www.historyandpolicy.org/papers/policy-paper-115.html>

21 Jonathan Sibun, 'Danny Blanchflower: The MPC is broken and blinkered', *Daily Telegraph* 6 December 2010.

1937 saw a recession in the US economy generally attributed to the government cutting back its public spending. The private sector did not then spring into action creating the jobs required.

for key high-tech materials, components and systems has led the DNI office to start such an effort.' [22]

There is no exact British equivalent of the DNI, but can you imagine how far the British political world would have to change for the state of British manufacturing to become an issue for either the Joint Intelligence Committee or the 2010–formed British National Security Council? [23]

Goldman Sachs

Amidst the thousands of inches of hard copy and screen pages discussing the ongoing Greek financial crisis, did anyone remind readers that the Greek government was only able to join the Euro in 2002 because it had faked its public debt figures with the help of Goldman Sachs? [24] Not that I have seen.

It was Matt Taibbi who described Goldman Sachs in an article in *Rolling Stone* as 'a great vampire squid wrapped around the face of humanity, relentlessly jamming its blood

22 <www.manufacturingnews.com/news/11/0203/intelligence.html>
23 The British NSC is officially described thus:
'The Prime Minister chairs the newly formed [2010] National Security Council (NSC), whose permanent members include the Deputy Prime Minister, the Chancellor of the Exchequer, the Foreign Secretary, the Home Secretary, the Defence Secretary, the Security Minister, the Secretary of State for International Development, the Secretary of State for Energy and Climate Change, Chief Secretary to the Treasury and the Cabinet Office Minister of State. Other Ministers and senior officials, including the Heads of the Intelligence Agencies, attend as required. The Council meets every week and is charged with overseeing and co-ordinating all aspects of Britain's security.'
24 They used some so-called 'cross-currency swaps' which enabled the Greek economy to meet the figure of debt at 60% of GDP demanded by the EU. See for example <www.spiegel.de/international/europe/0,1518,676634,00.html>

funnel into anything that smells like money.'[25] Without that kind of language, a report by staffers on the US Senate's Permanent Subcommittee on Investigations, comes to similar conclusions.[26] This is the introduction to its analysis of Goldman Sachs:

> 'The Goldman Sachs case study shows how one investment bank profited from the collapse of the mortgage market and engaged in troubling and sometimes abusive practices that raise multiple conflict of interest concerns. The first part of this case study shows how Goldman used structured finance products, including CDO, CDS, and ABX instruments, to take a proprietary net short position against the subprime mortgage market. Reaching its peak at $13.9 billion, Goldman's net short investments realized record gains for the Structured Products Group in 2007 of over $3.7 billion which, when combined with other mortgage losses, resulted in overall net revenues for Goldman's Mortgage Department of $1.1 billion. The second half of the case study shows how Goldman engaged in securitization practices that magnified risk in the market by selling high risk, poor quality mortgage products to investors around the world. The Hudson, Anderson, Timberwolf, and Abacus CDOs show how Goldman used these financial instruments to transfer risk associated with its high risk assets, assist a favored client make a $1 billion gain, and profit at the direct expense of the clients that invested in the Goldman CDOs. In addition, the case study shows how conflicts of interest related to proprietary investments led Goldman to conceal its adverse financial interests from potential investors, sell investors poor quality investments, and place its financial interests

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25 This essay is included in Taibbi's book *Griftopia* which is reviewed below and is on-line at <www.rollingstone.com/politics/news/the-great-american-bubble-machine-20100405>

26 <http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf>

before those of its clients.' (p. 376)

In other words, they created and sold a bunch of shitty financial products and then placed bets that the value of said products would fall. So why aren't they all in jail? This may have something to do with the fact that large numbers of Goldman Sachs people are or have been in the Obama administration.[27]

27 The details are at <www.goldmansachs666.com/2010/08/update-revolving-door-between-goldman.html>.