

**FINANCIAL INNOVATION, GROWTH,
CRASH, REGULATION – Capitalism in
Crisis!?**

Wilberne H. Persaud

End of Wall Street?

September 2008 – Image from one of the New York papers



Keynes Economic Consequences of the Peace – Strange document to become a bestseller!

Keynes in a passage the authenticity of which remains in dispute remarked: "Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some... Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose." We can't prove Lenin actually uttered these words attributed to him but their implications however, remain indisputably true.

Consequences of the Peace and WSM?

Why compare Consequences of the Peace and WSM? Can fallout from Wall Street's meltdown kill the dollar standard, destroy capitalism? Generally, the view is 'no it won't'. Yet US policy has not exhibited responses befitting its pre-eminent position as provider of the world's currency. Three-quarters of all US\$100 bills circulate outside continental USA. Charles De Gaulle's Finance Minister, Valéry Giscard d'Estaing, described the world's dollar standard as providing an 'exorbitant privilege' to the US.

Part of that privilege stems from the fact that whereas the US Bureau of Engraving and Printing spends but a few cents to produce each US\$100 bill, foreigners must give up US\$100 worth of real resources - actual goods and services - to hold one. Additionally, foreign firms, banks and, of course, central banks hold not only currency but also bonds of the US Treasury – central banks hold about US\$5 trillion of such bonds. China now counts billions of dollar-denominated financial instruments among its reserves. The IMF cannot set conditionalities for the USA.

Impacts

- Worry about the impact of financial crisis range from the sober academic and professional, to the fringe elements of both left and right in the political spectrum.
- Andrew Haldane, Bank of England's Executive Director for Financial Stability agrees that "the financial crisis of the past three years has, on any measure, been extremely costly. As in past financial crises, public sector debt seems set to double relative to national income in a number of countries. And measures of foregone output, now and in the future, put the net present value cost of the crisis at anywhere between one and five times annual world GDP.
- Fringe elements predict dire consequences like food riots, squatting, catastrophic dollar devaluation and worse.

Tea Party and Republican Politics: Troubled history of Race in the U.S. – Is this an unfortunate juxtaposition?

Millions of Americans remain underwater in home mortgages, without jobs, unable to service student loans and pay for college education among a whole slew of bad economic and life sustaining things. The world economy still totters at the brink of another great depression. The fix and stimulus has been too little and too late. The problem simply will not go away.

As Republicans block any and all attempts to truly reform Wall Street, and to institute an FDR-type solution a fresh, though not new phenomenon emerges: the 99% or Occupy Wall Street Movement (OWS)

Can this be the catalyst for preventing catastrophic impacts on the world economy? [Consider Euro resolution, Banks' haircut]

Protesters on the Brooklyn Bridge are stopped by a line of cops at the 'Occupy Wall Street' demonstration against the nation's financial system, October 1st, 2011.
Rolling Stone Magazine.



Protesters at the 'Occupy Wall Street' demonstration against the nation's financial system march to the Brooklyn Bridge, October 1st, 2011.



FDNY And NYPD Remove Occupy Wall Street Generators; Protesters Charge Political Motivation



Catherine Talese, left, and George Pingeon, right, pedal bicycles to charge lead acid batteries at Occupy Wall Street in Zuccoti Park Monday, Oct. 31, 2011 in New York. With the temperature dropping, protestors are stockpiling donated coats, blankets and scarves, trying to secure cots and military-grade tents, and getting survival tips from the homeless people who have joined their encampments. (AP Photo/Frank Franklin II)



New York City, Oct. 30, 2011: In Zuccotti Park, the original site of the Occupy Wall Street protests, demonstrators charge high-capacity boat batteries using bicycles retrofitted with small generators. Police, citing safety concerns, confiscated the protest's gas-powered generators. TIME Photos.



London, Oct. 31, 2011: A protester dressed as a zombie carries a placard in front of St. Paul's Cathedral. TIME Photo



Oakland, Calif., Nov. 2, 2011: Occupy Oakland demonstrators march on the Port of Oakland. Tens of thousands of protesters participated, as part of a general strike organized by Occupy Oakland. Port operations shut down for the evening. TIME Photo.



Oakland, Calif., Nov. 3, 2011: Occupy Oakland protesters light a fire on trash to make a barricade as police officers form a line to disperse the protesters. TIME Photo



Oakland, Calif., Nov. 2, 2011

Occupy Oakland protesters rally in front of the State of California building. A general strike — a hastily planned, ambitious action — was called to shut down the Port of Oakland. TIME Photo.



guardian.co.uk, Thursday 10 November 2011

Students protest over university tuition fees and public sector cuts.

Photograph: Ray Tang/Rex Features



A breakaway group of protesters begin to gather in London's Trafalgar Square
Photograph: Dan Kitwood/Getty Images



Protesters set up tents before being cleared by police in Trafalgar Square

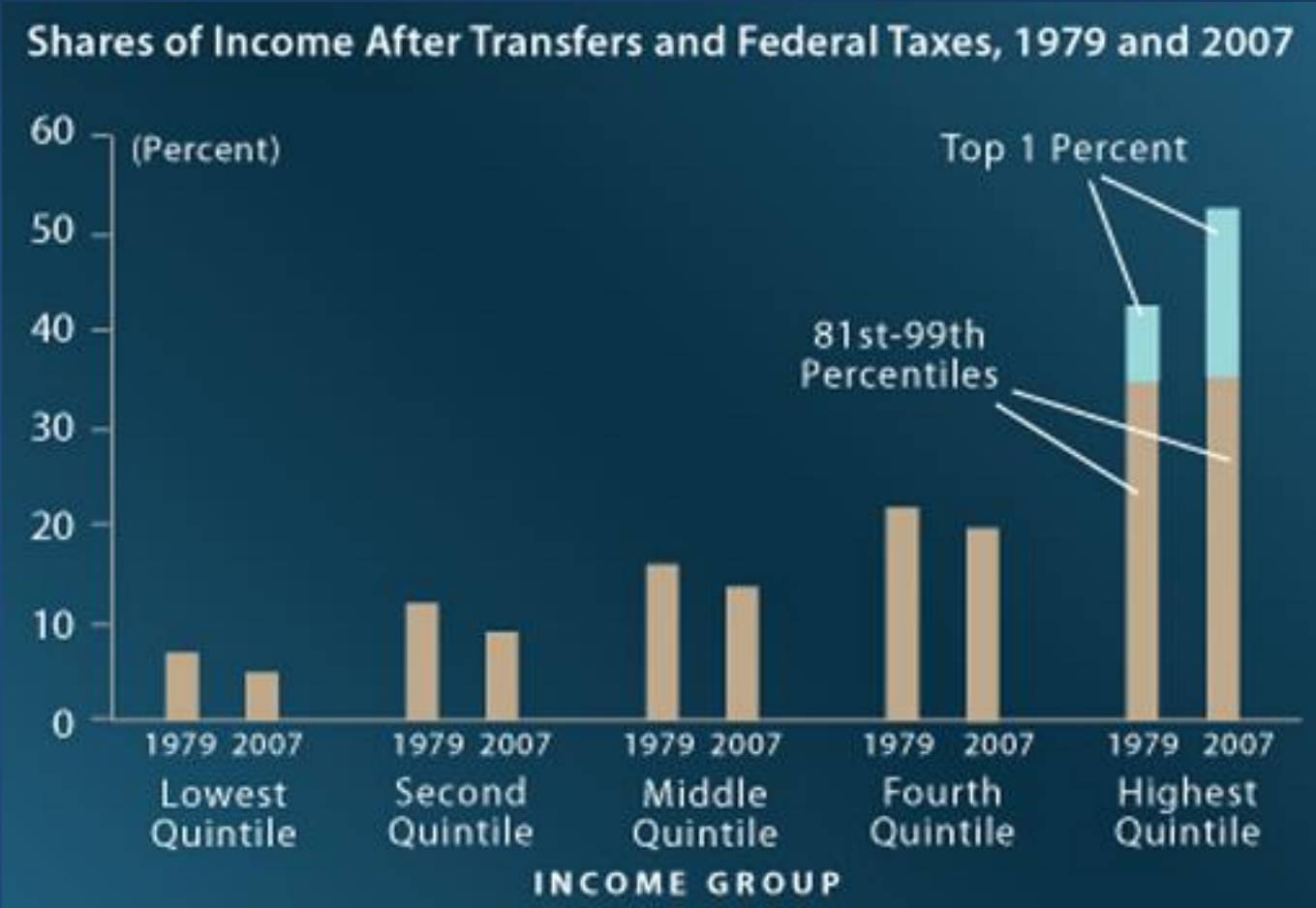
Photograph: Dan Kitwood/Getty Images



Students gather outside the University of London union building Photograph: Dan Kitwood/Getty Images



Source of the 99% OWS: CBO Trends in Distribution of Income



1999 opposition to Gramm-Leach-Bliley

Upon repeal of Glass-Steagall, Senator Byron L. Dorgan Democrat of North Dakota had this to say: "I think we will look back in 10 years' time and say we should not have done this but we did because we forgot the lessons of the past, and that that which is true in the 1930's is true in 2010 ... I wasn't around during the 1930's or the debate over Glass-Steagall. But I was here in the early 1980's when it was decided to allow the expansion of savings and loans. We have now decided in the name of modernization to forget the lessons of the past, of safety and of soundness." Remarkable, isn't it amazing: '99 to 2008 – 10 years' time almost exactly! Yet Dorgan couldn't predict the crash but he had a notion the policy was unsound.

The impact of the “Residual” – In defense of prudent stimulus

Abramovitz and Solow in the 1950s identified our extant ignorance of the true impact of technological change on output. Having accounted for capital and labour inputs in creation of output, a large residual remained. While Solow called it technical change, Abramovitz preferred the idea of seeing it as the extent of our ignorance of the way the economy actually worked!

Alexander Field found that the “overall growth of the residual between 1929 and 1941 was the highest of any comparable period in the twentieth century. This resulted from the combination of a still potent manufacturing contribution with advances in transportation, public utilities, and distribution, fueled in part by investments in public infrastructure.” Field’s claim may indeed be overly robust but the general point is valid. Nathan Rosenberg and Scott Stern spoke of the counterpoint to the macro-economic approach that equated technological change to “the residual” and treated innovation as exogenous to the economic system.

Infrastructure works link technology to pump priming. Shall popular protest rescue capitalism?

Capitalism's Creative Destruction

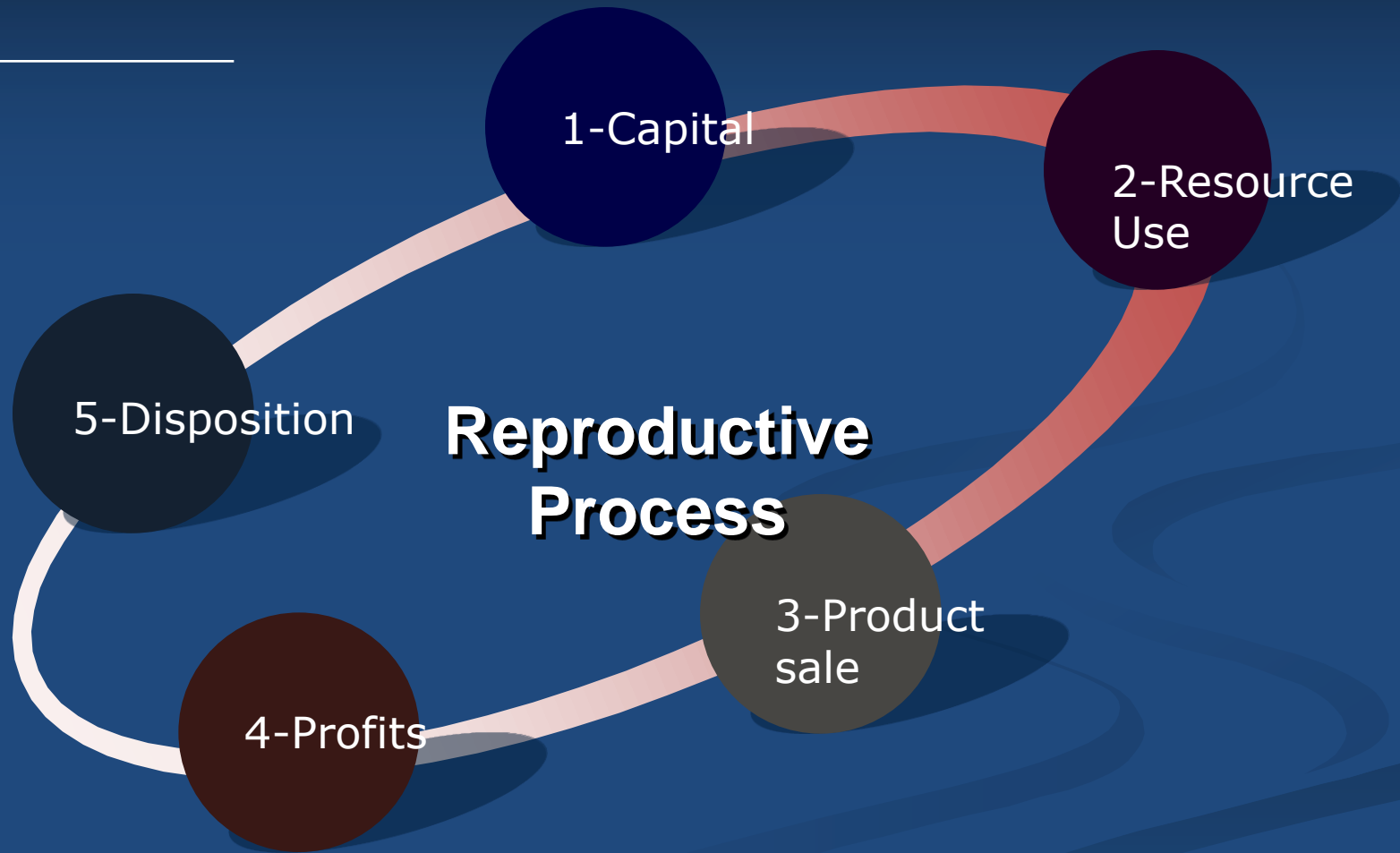
Sources of Growth & Prosperity

Historical Theory = Land, Labour, Capital

Abramovitz, Solow identify Residual = Tech Change

Back to Marx, Schumpeter to Grasp Core

Cycle: The Real Economy



Cycle: Financial Economy - Institutions, Legislation, Regulation

Financial Innovation

Crisis

Disaster Response

Consolidation, regulation

'til Death do us part! Financial crashes = Greed = Human Condition!?

- CLICO Jan 2009; Wall Street/World Sept/Oct. 2008—great recession; dotcom 2000; Long Term Capital Management 1998; Jamaica Meltdown mid-1990s; East Asia 1997; US Stock market 1987; US Savings and Loan bubble, 1985; Wall Street Crash 1929—worldwide depression; Barings London 1890; Overend and Guernsey London 1866; South Sea Bubble London 1720.... more...

Real Economy Impacts

- Consider following pictures – impacts of 2008 Wall Street crisis on behaviour in the real economy – examples from the USA

Mercedes Benz arrive: Long Beach Port



Mercedes Benz - Pileup



Paper Products for China Recycling



Return to sender - Empty



Bank of Jamaica Comment Ja Meltdown

- Instances of contagion within corporate conglomerates ... developed out of a deliberate reliance on the financial arm of a group to raise funds in support of weaker, risky ventures. Several cases of fraud, negligence and poor decision-making pointed to holes in management control systems that escaped auditors, boards and supervisors. Thus while macroeconomic conditions may have exposed weak banks, their vulnerability was accentuated by internal management failure and a culture of quick capital gains.

Today's Continuing recession Causes?

- Does the next slide give a hint? - “The Long-Term Outlook for the BRICs and N-11 Post Crisis, Goldman Sachs Global Economics”

A Future to FEAR?

	France	G'mny	Italy	Japan	UK	US
Brazil	2027	2029	2020	2034	2038	--
China	2006	2008	2004	2010	2006	2027
India	2021	2024	2017	2027	2023	--
Russia	2024	2029	2017	2037	2027	--

“Access to non-US markets enhances the competitiveness of the US financial services industry, benefitting its more than 5.77 million US employees, and further strengthening the entire US economy.”

Thus, the power of Wall Street, its Lobbyists and links to Washington defy attempts at a true resolution of the problem.

What Deregulation Trashed

- Glass-Steagall Act - control speculation, prohibit banks owning other financial institutions – investment banks, brokerage houses, merchant banks, insurance companies creating conflicts of interest. Enacted 1933 after excessive leverage and risk-taking contributed to the Great Depression. Glass-Steagall protected bankers from themselves! Metooism - Bankers = sheep - don't mind going over the cliff if everyone else goes over too.
- 73 years trashed.

Capitalism - Fundamental Elements

- Financial intermediation – Stress Intermediation
- Recall ‘Creative Destruction’
- Consider Alan Greenspan’s *‘mea culpa’* – a few weeks before House Committee on Oversight and Government Reform: *“Those of us who have looked to the self-interest of lending institutions to protect shareholders’ equity, myself included, are in a state of shocked disbelief.”* Discuss Greenspan’s *‘gravitas’* as FED Chair – the Oracle - Congress appeared unwilling to query stuff

Recurring Process

- The story of finance is ... one of innovation, crisis, and consolidation. Industrial, commercial, or technological change calls forth an innovation—paper trade credits, private company stocks and bonds, collateralized mortgage obligations, derivative instruments. Innovation solves an immediate problem—expanding trade, financing railroads, restructuring companies, stabilizing pension portfolios—and also triggers a period of greatly increased risk and instability. Institutional regulation catches up. The cycles are as apparent today as they were two hundred years ago.

Galbraith on 1929 Crash

- There is ... “a basic and recurrent process. It comes with rising prices, whether of stocks, real estate, works of art or anything else. This increase attracts attention and buyers, which produces the further effect of even higher prices. Expectations are thus justified by the very action that sends prices up. The process continues; optimism with its market effect is the order of the day. Prices go up even more. Then, **for reasons that will endless be debated, comes the end.** The descent is always more sudden than the increase; a balloon that has been punctured does not deflate in an orderly way.”

Global Financial System

- Bretton Woods, Keynes bancor, US veto creates modified Gold Standard US\$35 = 1 fine oz gold
- *de facto* change Nixon post-1971 US \$ = world currency
- Global Reach – UK, Iceland, Asia & China
- Emerging markets
- Caribbean
- Absent information comment speculative

Blame game – useful establish cause: Ideology misplaced

- “You had the authority to prevent irresponsible lending practices that led to the subprime mortgage crisis. You were advised to do so by many others,” said Representative Henry A. Waxman of California, Chairman of the committee. “Do you feel that your ideology pushed you to make decisions that you wish you had not made?”
- Greenspan: “Yes, I’ve found a flaw. I don’t know how significant or permanent it is. But I’ve been very distressed by that fact.” - FLAW PERMANENT!
- Moral Hazard – Discuss: President of US Steel Workers stark but funniest quotable: “Those workers who take a shower before they go to work, they get bailed out. The people who must take a shower after work, they get thrown out!”

Regulatory Framework Caribbean

- Adequacy of Legislation – Jamaica a decade ago Building Societies, etc.; adequacy of Institutions and personnel – Business Environment
- Jamaica 2008 – Pyramid schemes people trust more than Government
- Barbados, Guyana, OECS, Trinidad and Tobago – CLICO Jan 2009



END

- Thank You!