PIIGS, iTraxx SoyX, Neoliberalism, and Unshackled Finance Capital

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I. INTRODUCTION

Joseph Stiglitz, Nobel Prize winner in Economic Sciences, recently reminded us that “in the world of economics, things are never as they seem.” In these times of economic distress when conflicting facts and figures are swirling around us, it is helpful to be reminded of Albert Einstein’s caution: “It is theory that determines what can be observed.” In this context it is also useful to recall the adage: “You stand where you sit.” An example here is the current rate of unemployment in the United States (U.S.). We are told that the unemployment rate in the U.S. today is just under 10%. In the aggregate this is true. But when we see the unemployment rate along household income distribution, a different picture emerges.

The chart below shows that the burdens of hard economic times fall on different income groups differently. Here it is instructive to take into account an almost century-old statement of Andrew Mellon: “In a depression, assets return to their rightful owners.” The current Great Recession has substantiated Mellon’s proposition. Global losses in the financial sector alone exceed $3.6 trillion, and the bill for worldwide public rescue of financial institutions is $20 trillion. The special inspector general for the Troubled Asset Relief Program (TARP) estimates that the long-term total potential cost of just the U.S. tax-payers’ rescue of finance capital is

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$23.7 trillion - over 150 percent of GDP. We are also told that “Wall Street only became stronger as a result of the financial crisis.” Joseph Stiglitz reports that the 2008-09 bailout of the financial sector is “the largest redistributions of wealth in such a short period of time in history.” In order to unpack all of this, we will take a journey that will take us to Greece and then bring us back home.

Unemployment Rates in the U.S. for Workers in Selected Deciles of the Household Income Distribution. (in %) 4th Quarter 2009

II. PIIGS & iTraxx SovX

Over the last year, Greece has found itself at the epicenter of European debt crisis. PIIGS has become a short-hand for the countries facing serious debt servicing problem – Portugal, Ireland, Italy, Greece, and Spain. The following chart shows the debt to GDP ratio for PIIGS, along with the U.S.

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4 STIGLITZ, FREEFALL, supra note 1, at 200.
The iTraxx SovX Western Europe Index is an investment fund that represents an unweighted average of the credit default swap (CDS) spreads of fifteen European sovereign bond issuers. It was launched in September 2009, returned handsome profits to investors, and "let traders gamble on Greece . . . [as] derivatives . . . assumed an outsize role in Europe’s debt crisis."5 A financial expert opined that "the iTraxx SovX did not create the situation, but it has exacerbated it . . . Credit-default swaps give illusion of safety but actually increase systemic risk."6 Another expert termed credit derivatives "the most dangerous instruments yet," and added that "[i]nnovation has now cost us $7 trillion. That’s a pretty high price to pay for innovation."7

While iTraxx SovX multiplied its investors' wealth, Greece was brow-beaten by the bond markets and adopted severe "austerity" measures. These measures included wage freezes, public employee layoffs, sales tax hike of 21% on goods and services, a higher retirement age, and a role back of concessions won by the working classes over a generation. After foot-dragging for months, European Union (EU) leaders reached "extraordinary agreement" to provide a rescue package of $1 trillion—"a financial bazooka"—to stop the spreading debt crisis.5 The International Monetary Fund’s (IMF) and EU hope that the sum, which may rise to "more than a quarter of

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6 Id.


the bloc’s [GDP] [will] prevent troubled institutions from falling.’’ The plan came after “some not so subtle prodding” from President Obama, worried about the threat of the debt crisis to “the still-fragile” recoveries in the U.S. and Asia. Knowledgeable observers believe that the Greek bailout is likely to follow the model of the World Bank and IMF bailout of Russia after the 1998 default – “European tax payers paying for the bailout while investors in Greek debt are largely made whole.”

As the long, hot summer of 2010 comes to a close, the Greek debt still stands at 114 percent of its GDP. By 2040, Greece would have to spend 20 percent of its GDP to simply service this debt. The rescue package has “not paid down one penny. [It’s] just moving around a big pile of debt.” Even with interest rates around the world “stuck to the floor,” Greece has to pay 11 percent on its 5-year bonds, while Germany pays 1.4 percent. Many Europeans officials, including the French president, now believe that Europe’s banking problems and sovereign debt crisis are “largely the creation of speculators out to make a profit.” EU’s $1 trillion “financial bazooka” increasingly looks like the U.S. financial institution rescue plan, “a win-win-lose proposal: the banks win, investors win – and taxpayers lose.”

The debt crisis of Greece has brought into sharp relief the drastically uneven distribution of gain and pain in an economic crisis. This Greek tragedy also underscores that borrowing from the bond market to make up budgetary shortfalls rather than relying on taxation has a profound impact on public policies and accountability as the state becomes beholden to capital owning classes, particularly the bond market. The Greek debt crisis also substantiates that in the face of unbridled global mobility of finance capital, governments increasingly are “hostages to financial-market sentiments, [and] compelled to take account of investor concerns at every turn.” The thesis that unchecked international capital flows result in “dramatically more regressive income distribution and an effective veto over public policy,” has come true. In order to understand how this came about, we have to take into acco-


14 Joseph E. Stiglitz, Obama’s Ersatz Capitalism, N.Y. TIMES, Apr. 1, 2009, at A31. Stiglitz views these plans as “the kind of Rube Goldberg device that Wall Street loves – clever, complex and nontransparent, allowing huge transfers of wealth to the financial markets.” Id.


16 Id. Historically, increases in the mobility of taxable property had always forced political authorities to “bargain with those who possess property rights over the moveable tax base and to share with them formal control over the conduct of public affairs.” Id. (quoting Robert H. Bates & Da-Hsiang Donald Lien, A Note on Taxation, Development, and Representative
unt the neoliberal reordering of the U.S. and global financial system over the last thirty years.

III. CRISIS OF CAPITALISM AND THE KEYNESIAN COMPROMISE

We have to start with reminding ourselves of the twin chronic crises of capitalism: the tendency of the rate of profit to fall and the unsustainability of aggregate demand resulting in overproduction. Add to this the tendency of finance capital towards crisis. As Hayman Minski established, finance capital invariably goes through the cycle of hedge financing, speculative financing, Ponzi financing, and the “Minski moment” when the over-stretched institutions freeze credit and trigger in a system wide crisis.17 After a pause, the cycle starts all over again. The chart below shows this history of boom and bust of the financial sector.

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The 1929 crash and the subsequent Great Depression triggered a foundational change in economic theory and public policy. Keynesian economic theory and the New Deal aimed at saving capitalism from itself by containing the boom and bust cycles. The primary instrument to do so was establishing an elaborate system of public interventions and regulation of the market aimed at stabilizing aggregate demand and containing speculative tendencies of finance capital. This was also the birth of welfare systems. In the words of Asa Briggs:

A ‘welfare state’ is a state in which organized power is deliberately used (through politics and administration) in an effort to modify the play of market forces in at least three directions – first, by guaranteeing individuals and families a minimum income irrespective of the market value of their work or their property; second by narrowing the extent of ‘social contingencies’, for example, sickness, old age or unemployment) which lead otherwise to individual and family crises; and third by ensuring that all citizens without distinction of status or class are offered the best standards available in relation to an agreed range of social services.\(^\text{18}\)

It was this containment of capitalism that relatively leveled the playing field between capital-owners and the working classes, and opened the door for expansion of economic and civil rights. Following World War II, a similar system of contained and regulated international financial system was established at Bretton Woods. In the words of Henry Morgenthau, the aim was a “New Deal in international economics . . . driving the usurious money lenders out of the temple of international finance.”\(^\text{19}\) Pegging the dollar with gold, fixed exchange rates and cross-border capital controls were the hallmarks of this system. The combination of international and national regulations produced what is known as the “golden age of capitalism” - the period between 1945-71 that produced sustained growth and contained boom and bust cycles.

This golden age, however, came to an end; a death triggered by the fall of income of the capital owning classes and weakening of the dollar due to escalating U.S. balance of payment deficits. The two charts below show the career of the income of the wealth owning classes in the U.S.

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As these charts show clearly, the period of containment of finance capital and expansion of welfare systems put pressure on the income of the wealth owning classes. Concurrently, U.S. balance of payment deficits resulted in an outflow of dollars and the emergence of the unregulated Euromarket and the so-called Triffin dilemma – the Bretton Woods system had created an incentive for reserve banks around the world to accumulate dollars as their convertibility was guaranteed; however, the greater such accumulation is relative to U.S. gold reserves, the greater the risk to the guarantee. With overseas dollars rapidly exceeding gold reserves of
the U.S., the Bank of International Settlements (BIS) declared a "genuine dollar crisis" in 1971.

The first U.S. response to the crisis was the Nixon Shock of 1971 -- the end of dollar-gold convertibility. In effect, this amounted to a unilateral default. It, in turn, created a crisis of confidence of the bond market. What would it take for the bond markets to finance expanding U.S. balance of payment and fiscal deficits? Will the bond markets accept IOUs in the shape of U.S. Treasury Bills? This is the context of the birth of the neoliberal counterrevolution. I call it a counterrevolution, as it aimed at undoing the Keynesian welfare compromise between capital and labor. Here it is critical to understand the politics of monetary policy by way of its impact on inflation and unemployment. Inflation is the enemy of the bond market, while unemployment is the enemy of working classes. The neoliberal counterrevolution's immediate aim was suppression of inflation in the interest of the bond market.

IV. THE NEOLIBERAL COUNTERREVOLUTION

After road-tests in General Augusto Pinochet's Chile, where the "Chicago Boys" used tight monetary policy to break the back of labor unions, and in New York, where the city was forced to make spending cuts and unions were forced to make concessions in return for funding of deficits, neoliberalism was ready to be launched on a grand scale. The Volcker Shock of October 1979 was the opening blow that induced a severe recession which contained spiraling inflation and cutting unions down to size. The federal base rate rose from 8% in 1978 to 19% in 1981, and triggered the worst recession since the Great Depression. Output dropped by 2.2% in 1982 and unemployment reached 9.7%. Inflation dropped from 13.5% in 1980 to 3.2% in 1983. Confidence of the financial markets was restored through radical use of monetary policy. U.S. Treasury bills became "coin of the (global) realm," and secondary markets in bonds flourished. Paul Volcker characterized it as "the triumph of central banking." To sustain this radical monetary policy, a political counterrevolution was launched in the shape of the Reagan/Thatcher agenda aimed at strangulating the unions and starving the welfare state. This political agenda was facilitated by an ideological assault on the welfare systems. Margaret Thatcher famously summed up the posture: 'There is no such thing as society." "Culture wars" displaced class conflicts, and the war on poverty was turned into a war on the poor. Civil rights and women's rights were displaced by "family values," and working-class coalition by the "moral majority." The "efficient market hypothesis" of the Chicago school furnished intellectual heft to the project. It was claimed that


“the economic approach provides a useful framework for understanding all human behavior.”24 Inflation-busting through radical monetary policy, supply-side economic policy, and a promise of “trickle-down” became defining features of the U.S. political economy.

The neoliberal counterrevolution entailed an extensive redesigning of the regulatory regimes related to finance. Regulatory regimes born from the New Deal and the Keynesian consensus were set aside or drastically modified. In addition, a host of new regulations were fashioned to achieve hegemony of finance capital in particular. The critical legislations that enabled neoliberal financialization were the Depository Institutions Deregulation and Monetary Control Act of 1980, which eliminated interest rate caps; the addition of the 401K provision to the tax code in 1980, which channeled incomes into private pension plans; the Garn-St. Germain Depository Institutions Act of 1982, which lifted restrictions on the savings and loan industry to enter commercial lending and corporate bonds and allowed inter-state mergers between banks and S&Ls; the Secondary Mortgage Market Enhancement Act of 1984, which permitted investment banks to buy, pool, and resell mortgages in slices with varying levels of risk; the Tax Reform Act of 1986, which created the Real Estate Mortgage Investment Conduit, making mortgage-backed securities more attractive; the Financial Institutions Reform, Recovery, and Enhancement Act of 1989, which rearranged the government-sponsored entity landscape; the Interstate Banking and Branching Act of 1994, which allowed banks to operate across state lines; the Community Reinvestment Act, which directed financial institutions to expand their market base; the Gramm-Leach-Bliley Act (Financial Services Modernization Act) of 1999, which repealed the Glass-Steagall Act of 1933; the Commodities Futures Modernization Act of 2000, which left derivatives out of regulatory oversight; and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which made it difficult for consumers to seek the protections of bankruptcy. The courts and regulatory agencies played their supportive role. In 1986, the courts upheld the Federal Reserve’s ruling that commercial banks’ placing commercial paper issued by corporations with investors did not violate the Glass-Steagall Act. A November, 2001 rule jointly adopted by the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal


HeinOnline -- 1 Global Bus. L. Rev. 117 2010
Deposit Insurance Corporation (FDIC), and the Federal Reserve tied the bank capital requirement in securitization to the ability of banks to get rating agencies to approve the investment. On April 28, 2004, the Securities and Exchange Commission (SEC) agreed to allow large investment banks to use their own "risk management practices for regulatory purposes." This decision facilitated investment banks to increase their leverage to 40 to 1. The basic principle behind oligarchies, that economic power yields political power, translated well in the course of neoliberal regulatory design for finance capital, a design which substantiated George Stigler's thesis that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."26

One area that was significantly left out of the purview of regulatory oversight was derivatives, which were to wreak havoc down the road. This considered abdication came from a desire to both accelerate the hegemony of finance capital and the imperial role of the U.S. In November of 1999, the President’s Working Group on Financial Markets concluded that "to allow the United States to maintain leadership in these rapidly developing markets . . . derivatives should be exempt from federal regulation."27 Alan Greenspan, Chairman of the Federal Reserve, found regulation of derivatives "wholly unnecessary."28 Larry Summers, the Secretary of Treasury, said that one of his greatest achievements was ensuring that derivatives remain unregulated. With the end of the dollar's convertibility, and the move from fixed to floating rates, the measure-of-value property of money was rendered highly unstable. With this increased uncertainty, risk-assessment and risk-hedging became critical for capital that moves through multiple fluctuating currencies. The market for derivatives, instruments designed to hedge risk, grew exponentially. Because one did not have to have a stake in the underlying security to buy a derivative, they quickly became instruments of speculation rather than risk-management. Besides Credit Default Swaps, derivatives mushroomed as speculative bets on the movements of currencies, interest rates, bonds, and stocks. By 2008, derivatives had grown to $350 trillion in face value and $8 trillion in gross market value.

With the neoliberal counterrevolution underway, equity markets in the U.S. began to rise, propelled by inflow of funds from newly created funded pension schemes, and big companies increasingly started to rely on equity markets for finance. In response, commercial banks pushed lending into more marginal markets


26 George Stigler, The Theory of Economic Regulation, 1 BELL J. OF ECON. & MANG. SCI. 3 (1971). A century ago, Louis Brandeis argued that the “dominant element in our financial oligarchy is the investment banker.” LOUIS BRANDEIS, OTHER PEOPLE’S MONEY, AND HOW THE BANKERS USE IT 4 (1914). Today, Barney Frank, Chairman of the House Banking Committee, takes the position that financial institutions and instruments have taken “a large chunk of the economy hostage. And we have to pay ransom, like it or not. Barney Frank, quoted in ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM FROM CRISIS – AND THEMSELVES 38 (2009).


28 Kwak, supra note 3, at 8.
and developed new financial instruments and fee-and-commission activities. Lifting of New Deal banking restrictions accelerated the change towards fee and commissions and propriety trading of financial assets. This originate-and-distribute model rested on the creation of complex financial products and selling those quickly to investors and speculators around the world. With an “originate-and-distribute” model, “shadow banking” displaced traditional “boring banking.” The banks expanded the scope of the market by hunting out economically marginal groups for mortgage and consumer credit. In this process, “[e]conomically marginal people constituted, in effect, a ‘developing country’ within the United States.” Aggregate demand was now propelled by credit and with the rollback of the welfare state, the poor were to run a “private welfare system” based on credit. As the graphs below show, household debt exploded and the whole economy turned into primarily a debt-economy.

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30 Wade, supra note 23, at 31.
Composition of United States Debt in 1975 and 2005

Percentage of Indebted Families Whose Debt Service Payments are Above 40 Percent of Family Income

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Change in Debt vs. Goods Production as Percentages of GDP
(1959 = 100)

INDEX OF CHANGE (1959=100)

Debt as percentage of GDP

Total goods production as percentage of GDP

Private Debt as a Percent of GDP

PERCENT OF GDP

Non-financial business debt

Household debt

Financial sector debt

HeinOnline -- I Global Bus. L. Rev. 121 2010
GDP and Total Debt

Total Debt in the United States as a Percentage of the Economy
The share of finance capital in profits and incomes in the financial sector grew exponentially as the graphs below indicate.

\[\text{Figure 3-1: Real Corporate Profits, Financial vs. Nonfinancial Sectors}\]

\[\text{Chart 1. Total Financial Profits as Percentage of Total Domestic Profits}\]


Figure 4.1: Real Average Annual Compensation, Banking vs. Private Sector Overall

Source: Bureau of Economic Analysis, National Income and Product Accounts, Tables 1.1.4, 6.3, 6.6; calculation by the authors. Banking includes financial sector less insurance, real estate, and holding companies. Annual compensation is total wage and salary accounts divided by full-time equivalent employees.

Growth of Financial and Non-Financial Profits Relative to GDP
(1970 = 100)
The financial sector became the major source of income for the wealthy, incomes of CEO skyrocketed, and the share of income of the wealthy increased.
Chart 2. Primary Sources of Forbes 400 Wealth
(Percentages, Selected Years)

Retail*  Technology  Service  Finance  Oil/Gas
Food  Entertainment/Communications  Real Estate  Manufacturing  Other

*Retail in 1982 is included in Other.

CEOs' pay as a multiple of the average worker's pay, 1960-2007

Share of wealth held by the Bottom 99% and Top 1% in the United States, 1922-200
Rise in inequality was a natural result.
Average Household After-Tax Income
Including Public and Private Benefits, 1979 and 2006

|$1,200,000|
|$1,000,000|
|$800,000|
|$600,000|
|$400,000|
|$200,000|
|0|

11% rise 18% rise 21% rise 32% rise 55% rise

Poorest fifth Second fifth Middle fifth Fourth fifth 80th-99th Percentiles Top 1 Percent

Wage and Salary Disbursements as a Percentage of GDP

The financial markets relied on the Federal Reserve to keep the system awash with liquidity to sustain the credit-driven financialization. Particularly in response to
the dot.com crash of the early 2000s, the Federal Reserve lowered interest rates and kept them low, fueling excess liquidity and a credit-fueled boom. The supply of asset-backed securities doubled between 2003 and 2004, and doubled again between 2004 and 2005. The bond market thrived, as did capital owning classes.

V. THE SCORE-CARD OF NEOLIBERALISM

The score-card of the neoliberal counterrevolution shows spectacular gains for finance capital at the expense of the larger economy and the working classes. The record of neoliberalism in stimulating economic growth remained dismal even before the 2007-09 financial meltdown. Annual growth rates in the quarter century after 1973, while higher than the earlier period of global capitalism from 1820 to 1945, were below those achieved in the post-war "golden age."While aggregate growth rates were about 3.5% in the 1960s and 1970s, they were 1.4% in the 1980s, 1.1% in the 1990s, and below 1% after 2000. Income inequality increased in more than three-quarters of Organization for Economic Co-operation and Development (OECD) countries between the mid-1980s and mid-2000s. As the share of labor income shrank, the phenomenal expansion of the financial sector and its profits helped the share of business income in the OECD countries to rise from 28% in 1980 to 36% in 2003. While in 1982 financial corporations generated 8% of total U.S. corporate value added and 5% of total corporate profits, by 2007 their share of corporate value added rose to 16%, and their share of corporate profits went up eight times to 41%. By 2006, the profits per employee in banking were twenty-six times higher than the average in all other industries worldwide. Between 1973 and 2002, average real income for the bottom 90% fell by 9%, while the top one percent's real income rose by 101% and the top 0.1% by 277%. The share of national income by the top 1% of earners in the U.S. fell from a pre-World War II high of 16% to less than 8% by 1978. The neoliberal turn helped reverse the trend; by 2000, this share climbed back to 15%. The top 0.1% of income earners increased their share of the national income from 2% in 1978 to 6% by 1999. The ratio of median compensation of workers to the salaries of CEOs increased from thirty to one in 1970 to more than

35 Wade, supra note 23, at 33.
36 Tony Jackson, Has the Supercharged Banking Model Run Out of Control?, FINANCIAL TIMES, Jan. 21, 2008, available at http://www.ft.com/cms/s/0/d86da416-c763-11dc-a0b4-00007799fd2ac.html#axzz15xFsl0mO.
four hundred to one by 2000. The average hours worked by the average American have risen by equivalent to an extra month's work per year. The household debt and the corresponding debt servicing burden grew exponentially. The debt held by the U.S. financial sector grew from $2.9 trillion, or 125% of GDP, in 1978 to over $36 trillion, or 259% of GDP, in 2007. Between 1980 and 2000, assets held by the commercial banks and securities firms grew from 55% of GDP to 95%. Financial sector profits grew for 13% of all domestic corporate profits from 1978 to 1987 to 30% from 1998-2007. By 2004, the proportion of corporate profits in the U.S. going to finance doubled to over 28%, the shares going to the broader financial sector—combining finance, real estate and insurance—doubled to nearly 50%.

VI. NEOLIBERALISM GOES GLOBAL

The neoliberal global financial reordering required repositioning of the IMF as the global enforcer of the new neoliberal order. The role of the U.S.-dominated IMF was changed from being a currency stabilization fund to that of a manager of foreign debt crises. Concurrently, the IMF became a global enforcer of neoliberalization through structural adjustment programs imposed upon any state that needed its assistance with debt repayments. Debt crises were now used to enforce fiscal austerity, privatization, and market liberalization, the interlinked pillars of the Washington Consensus. In 1978, the IMF's Articles of Agreement were amended to redefine surveillance and expanded the scope of state policies that could be subjected to IMF scrutiny. New Guidelines on Conditionality released in 1979 ratified the expanded surveillance power and laid the basis for conditionality of structural adjustment that accompanied IMF assistance. The IMF purged Keynesian economists from its ranks and replaced them with neoliberal monetarists. Concurrently, the World Bank was turned into "strictly... a junior partner, with the guidelines of the programs dictated by the IMF." The World Bank's lending was switched from project-loans to structural adjustment loans subject to IMF's approval and accompanied by IMF-imposed conditionalities.

Keynesian cautions about international capital mobility were jettisoned. The new IMF dogma is unfettered mobility of capital. As a condition of providing loans to overcome balance of payment crises, IMF dictates macroeconomic policies of the

38 Task Force on Inequality and American Democracy, American Political Science Association, American Democracy in an Age of Rising Inequality 3 (2004); Harvey, supra note 32, at 16.


40 For the growth of U.S. household debt from 1980 to 2006, see Wolf, supra note 34, at 107.

41 See Kwak, supra note 3, at 59.

42 Id. at 85.

43 Id.

debtors reflecting an extreme free market ideology. Conditionalities to availability of funds now required structural adjustment programs; a policy package widely labeled “the Washington Consensus” dictated a comprehensive neoliberal economic policy. The package typically includes “harsh fiscal austerity,” privatization, and liberalization.

With the neoliberal financial regulatory regime of the U.S., the repositioning of the IMF, and the World Trade Organization’s (WTO) agreement on financial services in place, the hegemony of global finance capital under the U.S. imperial umbrella was complete. This neoliberal global financial regime thrives not only during phases of stability and growth, but also during phases of instability and crisis. Indeed, even natural disasters are turned into opportunities to enforce rabidly free market ideologies and policies. This is the context in which international debt crises increasingly served to entrench neoliberalism globally while feeding finance capital through accumulation by dispossession.

The neoliberal era has also been an era of incessant international debt crises starting with Latin America in the early 1980s. The fiction has been long cultivated that bad loans are always the debtor’s fault. However, in the case of Latin America, as in subsequent cases too, opportunistic and imprudent overdvertising by the banks fueled by access liquidity was the primary cause of excessive debt and the subsequent crisis. The massive lending to Latin America by U.S. banks in the 1970s was a prime mechanism to recycle petrodollars - the massive transfer of funds to the Organization of Petroleum Exporting Countries (OPEC) cartel as a result of the quadrupling of oil prices in 1973-74. The petrodollars quickly flowed back to Eurodollar deposits of U.S. banks. The oil price hike had also triggered a recession in industrialized countries, and the resulting weakness of internal demand came at a time when the major U.S. banks were losing market share at home. This made foreign lending more attractive. New markets were quickly found in the Global South, and the surplus capital in the U.S. started funding a lending boom in Latin America.

Banks found comfort in the fact that, as the Chairman of Citicorp put it, “Countries never go bankrupt.” The primary beneficiaries of the loans were technocrats, generals, and businessmen who received secret commissions and contracts on the huge flow of foreign funds. The massive debt was accompanied by massive capital


47 Id. at 8. The massive lending was proving very profitable. In the case of Citibank, for example, 72% of its 1976 earnings came from its international operations, and in 1977 profits from its Brazilian business exceeded those from its entire U.S. operation. See DARRELL DELAMAIDE, DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS 117 (1984).
flight from Latin America. The capital flight was propelled on one hand, by the incentives of the combination of high exchange rates and the history of inflation in the region, and, on the other, to distance assets from its often tainted origins. In the 1970s, during which Mexico accumulated $75 billion in foreign debt, its private sector accumulated $40 billion of foreign assets. In 1980-81, outflow of private capital from Argentina consisted of 84% of the inflow of debt, and in the case of Venezuela, the outflow exceeded the inflow. For Argentina, Mexico, and Venezuela combined, the three countries hit hardest by the debt crisis, capital flight during 1979-82 amounted to 67% of capital inflows.

Aggressive monetary policy in advanced capitalist countries designed to prevent domestic inflation, particularly the U.S., "imposed a frightful cost on the less developed world under the very loans the OECD governments had encouraged their banks to make." When the crisis hit, banks resisted advancing new fund, and Latin American governments imposed harsh austerity measure "at the behest of [their] creditors." The decisive response to the crisis was not market-driven but was choreographed by the U.S. state. After the aborted "Baker Plan," the "Brady Plan" was put in place in 1990. Skirting the option of debt forgiveness by official lenders to ease the debt burden, it focused on the debt to commercial banks through conversion of loans into collateralized bonds and debt-equity swaps. After conservable arm-twisting by regulators, banks converted 41% of the total debt into discounted principal bonds, 49% into discounted interest bonds, and advanced new money for the remaining 10%.

For the banks, the restructuring worked out rather well. It signaled an end of the debt crisis to the broader markets, and debtor countries could borrow and issue bonds again, generating fees for the banks. Loans having been converted into bonds, distressed assets went off the balance sheets and freed up capital for other uses. It gave the banks liquid bonds in place of the relatively illiquid loans, and triggered a turn-around in secondary market prices of these assets. By 1997, $305 billion of loans and $2.403 trillion of Brady bonds were traded in secondary markets. While the Brady Plan resolved the debt crisis from the perspective of creditors, the debt remains in place, to be serviced at the cost of domestic development and social services expenditures. Between 1982 and 1990, Latin America repaid far more than

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49 See WORLD BANK, WORLD DEVELOPMENT REPORT 1985 64 (1985).


52 For details of the Brady Plan, see id. at 39-54.

53 BUCKLEY, supra note 51, at 44. These are aggregate figures. Banks of different countries chose different combinations of the three parts. German banks converted most of their share into par bonds, Japanese banks chose discount bonds. Only U.S. and French banks advanced new funds. Differences in regulatory and tax regimes accounted for the variations. See id. at 44-45.
PIIGS, iTraxx SovX, NEOLIBERALISM

it received in new credits. Total indebtedness of Mexico, the country hardest hit by the crisis, remained unchanged as the relief afforded by the discounted bonds was offset by new loans. While before restructuring, Mexico’s net annual transfer to lending banks was $3.24 billion, after the restructuring it was $3.59 billion. The debt-servicing burden was borne by the most vulnerable who were denied health, education, housing, and life with dignity. The economic cost of the Latin American debt crisis was over two percent growth per year for the 1980s, and as a result it is considered the “lost decade in Latin America.”

The cycle repeated itself in the “tequila crisis” of the 1990s, the “Asian Flu” of 1997, the Russian default of 1998, and the Argentinean default of 2001. Banks from the Global North channeled global access liquidity into imprudent and speculative loans to developing economies. The debt burdens soon became unsustainable. The ensuing crises were then used by the Treasury-Wall Street-IMF complex to force further liberalization of capital markets and the financial sector. The cost was always borne by the working classes by way of austerity measures that typically involved a role back of the welfare safety net and reversal of wage concessions. The drama that has unfolded in Greece since the fall of 2009 has followed this script to the letter.

VII. U.S. CURRENT ACCOUNT DEFICIT: AN IMPERIAL TITHE?

The Americanization and liberalization of global finance did achieve a primary goal of the neoliberal counterrevolution. It made it possible for global savings to flow to the U.S. at an unprecedented scale. These capital flows can be seen as “an imperial tithe.” Because of the dominant imperial role of the U.S. in global finance, balance of payments deficits appear not to have the same implications for the U.S. as they do for any other state. As early as 1971, the Federal Reserve of Boston pointed that “this asymmetry appears to be appropriate, for it corresponds to an asymmetry in the real world.” In tune with this position, Paul O’Neill, U.S. Treasury Secretary, argued that for the U.S. the current account was a “meaningless concept.” Alan Greenspan placed the U.S. current account deficit “far down the list” of imbalances about which to be concerned. This is where an overwhelming

54 See Sachs, supra note 48, at 10.
55 BUCKLEY, supra note 51, at 46.
56 Id. at 22.
57 See Panitch, supra note 19, at 69.
58 Norman S. Fieleke & Federal Reserve Bank of Boston, Accounting for the Balance of Payments, NEW ENGLAND ECON. REV., (May/June 1971), at 12, quoted in MICHAEL HUDSON, SUPER IMPERIALISM: THE ORIGINS AND FUNDAMENTALS OF U.S. WORLD DOMINANCE 327 (2003) (emphasis added). Kindleberger was also of the view that transactions underlying the deficit were largely a “trade in liquidity profitable to both sides,” rather than a trade deficit or over-investment abroad as was commonly understood. EMILE DESPRES & WALLER SALANT, The Dollar and World Liquidity: a Minority View, THE ECONOMIST (1966), reprinted in CHARLES P. KINDLEBERGER, INTERNATIONAL MONEY: A COLLECTION OF ESSAYS 43 (1981).
non-market force comes into play, i.e., the U.S. imperial domination ensured that foreign exchange surplus from around the world, particularly from Asia, would fund escalating U.S. fiscal and current account deficits. Under the weight of this factor, the theory that exchange rates adjust in response to external imbalances became inoperative for the U.S. This has allowed the U.S. to become “the superpower of borrowing.” Due to the ability to borrow in its own currency, the U.S. monetary and fiscal policy “suffers from no external constraints . . . . Not so much a free lunch as an apparently ongoing free banquet.” The larger net effect of global neoliberal financial flows is to transfer capital from high-saving to low-saving countries. The United Nations estimates that in 2009 the net financial transfers (net capital flows minus investment income payments) from developing countries to the developed ones was $568 billion, compared with $891 billion in 2008.

The escalating U.S. current-account deficit and credit-driven consumer spending allowed the U.S. economy to function as “the ‘Keynesian engine’ of the global economy.” However, the end result of the debt-driven aggregate demand is that over the last thirty years the average U.S. household is working more hours for less pay and paying an increasing share of its income to creditor banks.

VIII. REGULATORY CAPTURE AND THE WALL STREET-WASHINGTON REVOLVING DOOR

Louis Brandeis cautioned in 1914 that “the dominant element in our financial oligarchy is the investment banker.” The Keynesian compromise and the New Deal regulatory regimes had put a check on the power of finance capital. The neoliberal re-regulation of the last thirty years dismantled those checks. The result was summed up by Senator Richard Durban in April 2009: “[The banks are] the most powerful lobby in Capitol Hill. And they frankly own the place.” Corporate media and establishment journalists have proved to be cheerleaders of the phenomenon. For example, Bob Woodward anointed Alan Greenspan as “Maestro” and credited him for orchestrating “the American Boom.” Time magazine, on their cover, called the Greenspan-Rubin-Summers trio “the Committee to Save the World.”

Of course, this was before the 2008-09 financial meltdown and the Great Recession. The debacle, however, did not slowdown the Wall Street-Washington revolving door. Many of the same finance capital minions who crafted the policies that resulted in the crash are now charged with fixing the broken system. Finance capital representatives remain a dominant presence in the Obama administration.

61 WOLF, supra note 34, at 4.
62 Id. at 100, 112.
63 See McNally, supra note 37, at 63.
Table 1. Financial Capital and the Obama Administration

<table>
<thead>
<tr>
<th>Name</th>
<th>Selected Finance-Related Positions</th>
<th>Connection to Financial Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timothy F. Geithner</td>
<td>Secretary of the Treasury</td>
<td>President and Chief Executive Officer, New York Federal Reserve; Rubine/Summers partnership</td>
</tr>
<tr>
<td>Neal S. Wolin</td>
<td>Deputy Secretary of the Treasury</td>
<td>2001-07 Executive Vice President, Hartford Financial Services Group; 2007-09 President, Property &amp; Casualty Operations, Hartford</td>
</tr>
<tr>
<td>Mark A. Patterson</td>
<td>Chief of Staff to Treasury Secretary</td>
<td>2004-07 Vice President and lobbyist, Goldman Sachs; 2007-08 Managing Director</td>
</tr>
<tr>
<td>Jeffrey A. Goldstein</td>
<td>Under Secretary for Domestic Finance (in charge of oversight of IARP)</td>
<td>2004-2010 Partner, Managing Director, Goldman Sachs, private equity firm; partnership income around $30 million over 15-month period (2008-2009), plus from $5 to $25 million in bonus</td>
</tr>
<tr>
<td>Herbert M. Allison, Jr.</td>
<td>Assistant Secretary for Financial Stability and Counselor to the Secretary</td>
<td>1971-1999 Merrill Lynch various capacities (1997-1999 President); 2008-09 President and CEO, Fannie Mae</td>
</tr>
<tr>
<td>Michael S. Barr</td>
<td>Assistant Secretary for Financial Institutions</td>
<td>Former Special Assistant to Treasury Secretary Rubin</td>
</tr>
<tr>
<td>Mary John Miller</td>
<td>Assistant Secretary for Financial Markets</td>
<td>26 years at T. Rowe Price Group; 2004-08 Director, Fixed Income Division</td>
</tr>
<tr>
<td>Martha Lago</td>
<td>Assistant Secretary for International Markets and Development</td>
<td>2001-08 Citigroup Global Head of Compliance</td>
</tr>
<tr>
<td>Kim N. Wallace</td>
<td>Assistant Secretary for Legislative Affairs</td>
<td>1994-2000 Vice President of Equity Research and Telecommunications Analysis, Lehman Brothers; 2008-09 Managing Director, Bank of America</td>
</tr>
<tr>
<td>Gene Spiegel</td>
<td>Counselor to the Secretary of the Treasury</td>
<td>Former Director of National Economic Council; 2006 Consultant for Goldman Sachs (paid $187,000); Rubine/Summers partnership</td>
</tr>
<tr>
<td>Matthew Kabaker</td>
<td>Deputy Assistant Secretary of Treasury</td>
<td>1998-2009 Managing Director, Blackstone Group, LP</td>
</tr>
<tr>
<td>Lewis Alexander</td>
<td>Counselor to Treasury Secretary Geithner</td>
<td>1999-2009 Chief Economist, Citigroup</td>
</tr>
<tr>
<td>Lawrence H. Summers</td>
<td>Director of National Economic Council</td>
<td>Former Treasury Secretary under Rubin; 2007-2008 part-time Managing Director, hedge fund B.E. Shaw; 2008 received $5 million in compensation, $2.6 million in speaking fees from financial sector</td>
</tr>
<tr>
<td>Jason Furman</td>
<td>Deputy Director, National Economic Council</td>
<td>2007-08 Director of Hamilton Project, Brookings Institute (founded by Rubin)</td>
</tr>
<tr>
<td>Paul Volcker</td>
<td>Economic Recovery Advisory Board Chair</td>
<td>1965-69 Vice President, Chase Manhattan; 1979-87 Federal Reserve Chairman</td>
</tr>
<tr>
<td>Adam Starch</td>
<td>Chief Operating Officer of the Securities and Exchange Commission's Enforcement Division</td>
<td>2004-09 Goldman Sachs Vice President in the Business Intelligence Group</td>
</tr>
<tr>
<td>Gary Gensler</td>
<td>Chairman, Commodity Futures Trading Commission</td>
<td>1998-97 Partner, Goldman Sachs (various positions); Undersecretary of the Treasury for Rubin/Summers</td>
</tr>
<tr>
<td>Rehn Emanuel</td>
<td>White House Chief of Staff</td>
<td>1999-2002 Investment banker at Dreidner Kleinwort Wasserstein; former board member Fannie Mae</td>
</tr>
<tr>
<td>Michael Froman</td>
<td>Deputy Assistant to the President and Deputy National Security Advisor</td>
<td>1999-2009 Citigroup executive, including Managing Director, President and CEO of Citizens; Rubin's chief of staff</td>
</tr>
<tr>
<td>Peter Orszag</td>
<td>Budget Director</td>
<td>Director, Hamilton Project, Brookings (founded by Rubin)</td>
</tr>
</tbody>
</table>


One indicator of finance capital’s influence over public policy is the sheer size of the 2008-09 financial sector bailout compared to other major outlays of public spending in U.S. history.66

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<table>
<thead>
<tr>
<th>Big Budget Expenditure</th>
<th>Cost</th>
<th>Inflation Adjusted Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marshall Plan</td>
<td>$12.7 billion</td>
<td>$115.3 billion</td>
</tr>
<tr>
<td>Louisiana Purchase</td>
<td>$15 million</td>
<td>$217 billion</td>
</tr>
<tr>
<td>Race to the Moon</td>
<td>$36.4 billion</td>
<td>$237 billion</td>
</tr>
<tr>
<td>S&amp;L Crisis</td>
<td>$153 billion</td>
<td>$256 billion</td>
</tr>
<tr>
<td>Korean War</td>
<td>$54 billion</td>
<td>$454 billion</td>
</tr>
<tr>
<td>The New Deal</td>
<td>$32 billion (est.)</td>
<td>$500 billion (est.)</td>
</tr>
<tr>
<td>Gulf War II/Invasion of Iraq</td>
<td>$551 billion</td>
<td>$597 billion</td>
</tr>
<tr>
<td>Vietnam War</td>
<td>$111 billion</td>
<td>$698 billion</td>
</tr>
<tr>
<td>NASA</td>
<td>$416.7 billion</td>
<td>$851.2 billion</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$3.92 trillion</td>
</tr>
</tbody>
</table>

Table 14.1 Bailout Tally

<table>
<thead>
<tr>
<th>Federal Reserve - $5.255 trillion - 62%</th>
<th>Maximum Amount</th>
<th>Current Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Paper Funding Facility LLC (CPFF)</td>
<td>1,800,000,000,000</td>
<td>270,879,000,000</td>
</tr>
<tr>
<td>Term Auction Facility (TAF) Other Assets</td>
<td>900,000,000,000</td>
<td>415,302,000,000</td>
</tr>
<tr>
<td>Money Market Investor Funding Facility (MMIFP)</td>
<td>601,963,000,000</td>
<td>601,963,000,000</td>
</tr>
<tr>
<td>Unnamed MBS Program Announced 11/25/08 Term Securities Lending Facility (TSLF)</td>
<td>500,000,000,000</td>
<td>190,200,000,000</td>
</tr>
<tr>
<td>Term Asset-Backed Securities Loan Facility (TALF) Other Credit Extensions (AIG)</td>
<td>200,000,000,000</td>
<td>122,800,000,000</td>
</tr>
<tr>
<td>Unnamed GSE Program Announced 11/25/08 Primary Credit Discount</td>
<td>122,800,000,000</td>
<td>92,600,000,000</td>
</tr>
<tr>
<td>Primary Dealer and Others (PDCP)</td>
<td>10,300,000,000</td>
<td>10,300,000,000</td>
</tr>
<tr>
<td>Net Portfolio Maiden Lane LLC (Bear Sterns)</td>
<td>300,000,000,000</td>
<td>300,000,000,000</td>
</tr>
<tr>
<td>Securities Lending Overnight</td>
<td>750,000,000,000</td>
<td>750,000,000,000</td>
</tr>
<tr>
<td>Longer-Term Treasury Purchase (3/18/09) Agency debt purchase (3/18/09)</td>
<td>100,000,000,000</td>
<td>100,000,000,000</td>
</tr>
<tr>
<td>Agency mortgage-backed securities (3/18/09)</td>
<td>1,274,873,000,000</td>
<td>1,274,873,000,000</td>
</tr>
</tbody>
</table>

Federal Deposit Insurance Corporation - $1.788 trillion - 21%

| FDIC Liquidity Guarantees | 1,400,000,000,000 | 1,400,000,000,000 |
| Loan Guarantee to Citigroup | 249,300,000,000  | 249,300,000,000  |
| Loan Guarantee to Lending Arm of General Electric | 139,000,000,000 | 139,000,000,000 |

Treasury Department - $1.15 trillion - 13.5%

| Troubled Asset Relief Program (TARP) Fannie Mae/Freddie Mac Bailout | 700,000,000,000 | 700,000,000,000 |
| Stimulus Package | 168,000,000,000 | 168,000,000,000 |
| Treasury Exchange Stabilization Fund (ESF) Tax Breaks for Banks | 50,000,000,000 | 50,000,000,000 |
| 29,000,000,000 | 29,000,000,000 |
| Stimulus Program (2009) Homeowner Affordability and Stability Plan (2009) | 787,000,000,000 | 787,000,000,000 |
| 75,000,000,000 | 75,000,000,000 |

Federal Housing Administration - $300 billion - 3.5%

| Hope for Homeowners | 300,000,000,000 | 300,000,000,000 |
| Total - 100% | 10,502,392,000,000 | 4,274,873,000,000 |
To make matters worse, lack of transparency in critical areas of financial policy remains entrenched. For example, when Bloomberg News sought information about the identity of beneficiaries of the 2008-09 bailouts, the Federal Reserve claimed that the Freedom of Information Act did not extend to it. When Judge Loretta Presca of the District Court of New York ruled against the Federal Reserve in this matter in August 2009, the Federal Reserve appealed. The lack of transparency translates into a lack of political accountability. It is no wonder that the recent legislative deliberations about financial reforms were termed by a Congressional aide “a fake debate,” and the final legislative package has been termed “Wall Street’s Big Win.” Where there are winners, there are losers. The working classes lost out and now face a “jobless recovery” and further shrinking of public services and welfare safety nets.

IX. CONCLUSION

Banking and finance play a critical role in the economy by channeling savings towards productive investments. By the early twentieth century the lessons were learned that, left to its own devices, finance capital tends towards unbridled speculation and ends up playing havoc with the economy. The collective response was a Keynesian compromise whereby finance capital was regulated both nationally and internationally to put a check on speculation and to channel it to support the productive economy. The result was an extended period of economic growth and stability. Over the last thirty years, the neoliberal counter revolution reversed these regimes and facilitated hegemony of finance capital. The result has been instability and a widening of the gap between the rich and the poor. The 2008-09 financial meltdown and the resulting Great Recession have furnished an opportunity to change course and to contain the power and machinations of finance capital. Over 200 years ago, Thomas Jefferson cautioned, “banking institutions are more dangerous than standing armies.” Today, in “the age of leverage” and derivatives, finance capital equipped with “financial weapons of mass destruction” can and do inflict more destruction than an eighteenth century standing army ever could. To guard against such destruction the working classes must insist upon transparency and accountability of the finance capital. In order to protect democracy and the future of the society, the oligarchy of finance capital must end.

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67 Kwak, supra note 3, at 14 (quoting Letter from Thomas Jefferson to John Taylor (1816), in The Writings of Thomas Jefferson, Vol. XV, at 23 (Thomas Jefferson Memorial Association, 1907)).

