

The Unz Review • An Alternative Media Selection

A Collection of Interesting, Important, and Controversial Perspectives Largely Excluded from the American Mainstream Media

A Short History of Bubblenomics

Who Wins and Who Loses

MIKE WHITNEY • MAY 6, 2011 • 2,400 WORDS • 1 COMMENT Q&A



Assets bubbles require massive amounts of leverage. But too much leverage can destabilize the system, so it needs to be regulated. But Wall Street doesn't like restrictions on leverage because it can make more money by borrowing like crazy, inflating a ginormous bubble, skimming off the profits, and cashing in before the crash. So, the Fed ignores Wall Street's "gearing" operations and pretends not to see what's going on. It becomes a bubble "enabler" by lowering interest rates, easing credit and waving-off tighter regulations. It's all part of the game. The Fed works to help its core constituents while everyone else is put at risk.

But there's another reason for bubbles, too. Stagnation is a chronic problem in mature capitalist economies. As businesses become more efficient in their various widget-making operations, demand for their products drops off making it harder for owners to find profitable outlets for investment. And when investment starts to flag, then grip of economic inertia begins to tighten. As author Robert Skidelsky says, "investment fills the gap between production and consumption", so when investment hits a speed-bump, spending starts to wither and the economy slows to a crawl.

The Fed's remedy: Zero rates, easy money and more bubbles; Professor Bernanke's one-size-fits-all, magic elixir for sclerotic economies. In other words, the emerging stock and commodities bubbles are not a sign that the Fed is flubbing the policy. Bubbles are the policy, and have been for a very long time. Bernanke is no fool. He knows that each business cycle is weaker than the last, creating fewer jobs, more slack in the economy, and more anemic growth. His job is to endlessly tweak the process in order to maintain profitability for the people at the top of the economic foodchain, his real bosses.

Here's a clip from an interview with history professor Robert Brenner who sums it up perfectly:

Robert Brenner:

“... Economic forecasters have underestimated how bad the current crisis is because they have over-estimated the strength of the real economy and failed to take into account the extent of its dependence upon a buildup of debt that relied on asset price bubbles. In the U.S., during the recent business cycle of the years 2001-2007, GDP growth was by far the slowest of the postwar epoch. There was no increase in private sector employment. The increase in plants and equipment was about a third of the previous, a postwar low. Real wages were basically flat. There was no increase in median family income for the first time since World War II. Economic growth was driven entirely by personal consumption and residential investment, made possible by easy credit and rising house prices. Economic performance was weak, even despite the enormous stimulus from the housing bubble and the Bush administration’s huge federal deficits. Housing by itself accounted for almost one-third of the growth of GDP and close to half of the increase in employment in the years 2001-2005. It was, therefore, to be expected that when the housing bubble burst, consumption and residential investment would fall, and the economy would plunge.” (“Overproduction not Financial Collapse is the Heart of the Crisis”, Robert P. Brenner speaks with Jeong Seong-jin, Asia Pacific Journal)

Sound familiar? Flat wages, weak demand, slow growth and more and more debt? All signs of an aging, hobbled system that’s slipping inexorably into stagnation. This is why the Fed adopted its present policy of bubblemaking, because the only way to avoid stagnation is by increasing the debt-load. Authors John Bellamy Foster and Fred Magdoff traced the origins of the policy back to the 1970s. They revealed what their findings in an article in *The Monthly Review* titled “Financial Implosion and Stagnation”. Here’s an excerpt:

“It was the reality of economic stagnation beginning in the 1970s, as heterodox economists Riccardo Bellofiore and Joseph Halevi have recently emphasized, that led to the emergence of “the new financialized capitalist regime,” a kind of “paradoxical financial Keynesianism” whereby demand in the economy was stimulated primarily “thanks to asset-bubbles.” Moreover, it was the leading role of the United States in generating such bubbles?despite (and also because of) the weakening of capital accumulation proper?together with the dollar’s reserve currency status, that made U.S. monopoly-finance capital the “catalyst of world effective demand,” beginning in the 1980s. But such a financialized growth pattern was unable to produce rapid economic advance for any length of time, and was unsustainable, leading to bigger bubbles that periodically burst, bringing stagnation more and more to the surface.

A key element in explaining this whole dynamic is to be found in the falling ratio of wages and salaries as a percentage of national income in the United States. Stagnation in the 1970s led capital to launch an accelerated class war against workers to raise profits by pushing labor costs down. The result was decades of increasing inequality.” (“Financial Implosion and Stagnation”, John Bellamy Foster and Fred Magdoff, *Monthly Review*)

Foster and Magdoff do a fine job of explaining how the system has been rejiggered to overcome stagnation. Financial assets provide a place where surplus capital can go and grow via paper profits. But this type of investment does not add to productive capacity or real wealth; it merely enlarges the amount of money capital while creating the means for transferring wealth from one class to another. And that’s the point. Every burst bubble thrusts middle class households further and further into the red, while bank moguls and Wall Street tycoons get even richer. It is all by design, nothing is left to chance.

It might surprise you to know that the Fed has become so skilled at bubble-making, that the condition of the underlying economy doesn’t really matter any more. By fixing interest rates below the rate of inflation and attaching a liquidity-tailpipe to the stock market (QE2), the Fed

has been able engineer a boom in equities, while the so-called “real” economy languishes in a near-Depression. In fact, consumer credit is actually shrinking (excluding student loans) while margin debt (the amount that speculators borrow to buy stocks) continues to soar. This is an astonishing development. The Fed has created a bifurcated market where bankers and hedge fund managers are able to rake in billions off their gaming operations while 300 million working Americans remain mired in debt.

But there are a few drawbacks to the Fed’s policy. After all, one can only hollow out the economy for so long before the society begins to unravel. But, unfortunately, widening inequality and destitution don’t show up in GDP, which continues to balloon even while working people slip further into debt. What’s missing in the GDP-readings is the fact that we are getting poorer as a nation and weaker as an economic force in the world. Here’s how Rob Arnott of Research Affiliates summed it up in an article in Fortune magazine:

“We are, in a word, considerably poorer than we imagine ? something politicians of all stripes should, but probably won’t, consider as they grapple with our massive deficit. GDP that stems from new debt ? mainly deficit spending ? is phony: it is debt-financed consumption, not prosperity,” Arnott writes. “Net of deficit spending, our prosperity is nearly unchanged from 1998, 13 years ago.”...

“Instead of the financial world being the lubricant for business, they are out there manufacturing products with no utility whatsoever except for generating fees,” he said. “Somebody’s got to do something about Wall Street. It is destroying the country.” (“Lost decade? We’ve already had one, Fortune)

The growth we see in rising GDP is mainly “attributable to debt-financed spending, rather than real wealth creation.” Indeed, Bernanke is merely leveraging his way out of a Depression. But the calamitous downstream effects of the policy are obvious; the middle class is being decimated, the dollar is getting hammered, and the productive sectors of the economy are being cannibalized. These are the failures of bubblemaking, a theory whose sole purpose is to further enrich a tiny segment of the population that’s already as rich as Croesus.

But the Fed is not the worst offender in this regard. The real problem is the banks.

The Fed can induce spending by lowering interest rates, easing credit or buying bonds, but the banks do the heavy lifting. That’s where the zillions in leverage are created via off-balance sheets operations, repo transactions and derivatives contracts. These asset-pumping operations remain largely concealed from the public, so no one really knows what’s going on. That’s why the connection between money supply and financial asset prices is so tenuous and misleading, because the banks create money that doesn’t appear in the data. That’s what off-balance sheets operations are all about. They generate unknown amounts of credit which stimulates activity, but remains invisible. The printing presses have essentially been handed over to private industry. Here’s how it all works according to Independent Strategy’s David Roche

“The reason for the exponential growth in credit, but not in broad money, was simply that banks didn’t keep their loans on their books any more ? and only loans on bank balance sheets get counted as money. Now, as soon as banks made a loan, they “securitized” it and moved it off their balance sheet.

There were two ways of doing this. One was to sell the securitized loan as a bond. The other was “synthetic” securitization: for example, using derivatives to get rid of the default risk (with

credit default swaps) and lock in the interest rate due on the loan (with interest-rate swaps). Both forms of securitization meant that the lending bank was free to make new loans without using up any of its lending capacity once its existing loans had been “securitized.”

So, to redefine liquidity under what I call New Monetarism, one must add, to the traditional definition of broad money, all the credit being created and moved off banks’ balance sheets and onto the balance sheets of nonbank financial intermediaries. This new form of liquidity changed the very nature of the credit beast. What now determined credit growth was risk appetite: the readiness of companies and individuals to run their businesses with higher levels of debt.” (“The Global Money Machine”, David Roche, Wall Street Journal)

The Fed is not the main culprit in this new paradigm where banks and shadow banks stealthily add to the money supply without any oversight. The problem is the lack of regulation. There needs to be strictly enforced guidelines on the amount of leverage a bank can use and—more importantly—any financial institution that acts like a bank must be regulated like a bank. (Dodd-Frank reforms don’t fix this problem.)

The present system is doomed because it depends on the willingness of bankers to behave ethically when all the incentives are pulling them in the opposite direction. The rewards for gouging the public are just too great to resist. All one has to do is lend tons of money to people who can’t repay the debt, sell those same loans to investors looking for higher yield, skim-off the profits in stock options and bonuses, and find a safe place when the bubble bursts. Wash, rinse, repeat.

The IMF released a report last week that confirms this basic theory. The report aptly titled “A Fistful of Dollars” shows how the worst offenders deployed their lobbyists to ease regulations in order to legalize the type of sleight-of-hand that triggered the crash. Here’s an excerpt:

“We find that lobbying was associated with more risk-taking during 2000-07 and with worse outcomes in 2008. In particular, lenders lobbying more intensively on issues related to mortgage lending and securitization (i) originated mortgages with higher loan-to-income ratios, (ii) securitized a faster growing proportion of their loans, and (iii) had faster growing originations of mortgages. Moreover, delinquency rates in 2008 were higher in areas where lobbying lenders’ mortgage lending grew faster. These lenders also experienced negative abnormal stock returns during the rescue of Bear Stearns and the collapse of Lehman Brothers, but positive abnormal returns when the bailout was announced. Finally, we find a higher bailout probability for lobbying lenders. These findings suggest that lending by politically active lenders played a role in accumulation of risks and thus contributed to the financial crisis.....

CONCLUSION

.....We carefully construct a database at the lender level combining information on loan characteristics and lobbying expenditures on laws and regulations related to mortgage lending and securitization. We show that lenders that lobby more intensively on these specific issues engaged in riskier lending practices ex ante, suffered from worse outcomes ex post, and benefited more from the bailout program.”

(“A Fistful of Dollars: Lobbying and the Financial Crisis”, Deniz Igan, Prachi Mishra, and Thierry Tressel, Research Department, IMF)

There it is in black and white. The bankers gamed the system and raked in trillions, all according to plan. Not surprisingly, they used their political clout to create a safety net for themselves (TARP) when the bubble burst, while everyone else watched as their retirement savings and home equity went up in smoke.

There's no disputing that massive leverage played a critical role in the crash of '08. Nor is there any doubt that hawking mortgage-backed securities (MBS) and other garbage assets (CDOs, ABS) to credulous investors was the main vehicle for executing the heist. So, why hasn't the Fed acknowledged its mistakes and stepped up its supervision of the banks? Is Bernanke so "captured" by Wall Street that he'd rather see another meltdown than take steps to reign in leverage? That seems to be the case.

Here's how Bernanke responded to Keith Ellison, when the congressman explicitly warned Bernanke of "excessive leverage" that had reached "stratospheric levels" putting the entire system in danger.

Bernanke: "The Board's authority and flexibility in establishing capital requirements, including leverage requirements, have been key to the Board's ability to require additional capital where needed based on a banking organization's risk profile..."

We note that in other contexts, statutorily prescribed minimum leverage ratios have not necessarily served prudential regulators of financial institutions well." ("Excessive Leverage Helped Cause the Great Depression and the Current Crisis ... And Government Responds by Encouraging MORE Leverage", Washington's blog)

"Minimum leverage ratios" will not make the system safer and more stable?!? You gotta be kidding me?

This is Bernanke's way of saying that he understands the risks, but plans to do nothing.

But, why?

Because Bernanke's job is to assure that Wall Street's massive looting operation continues apace. That's Job#1. And, while "systemic instability" may be a concern, it's largely irrelevant. Maintaining profitability for uber-rich speculators takes precedent over everything else. That's the way Bubblenomics is designed to work.

Mike Whitney lives in Washington state and can be reached at fergiewhitney@msn.com

(Republished from [CounterPunch](#) by permission of author or representative)