



From credit crunch to meltdown – how the bankers broke the system

*Paul Mason has followed his successful first book, *Live Working or Die Fighting*, with a new one about the banking collapse. It is, says Keith Harvey, a lively account and useful analysis of the road to disaster*

MELTDOWN: THE END OF THE AGE OF GREED
Paul Mason, Verso April 2009, £9.99

PAUL MASON is something of an exception in broadcast journalism. As BBC2's *Newsnight*'s economics editor he succeeded Evan Davies and Stephanie Flanders (now the BBC's economic editor) to the job, after a few years as the programme's business editor.

Unlike them he is not an Oxbridge graduate. Neither does he have, like Robert Preston the BBC's business editor, a fast-track to the inside dope from Gordon Brown's No 10 team. In contrast to his colleagues Mason is a socialist (he is also *Newsnight*'s NUJ rep) and has been, in his day, a political activist.

Paul Mason's first book (*Live Working or Die Fighting*) makes abundantly clear that, despite his job, he is not enamoured of the titans of high finance and big business, but rather sides with the global working class in its many international struggles for social justice. For this reason he is regularly vilified on right wing blogs.

His *Newsnight* films and reports do not fixate on stock market indices and currency movements. They try to dig down and find the human story, whether it be the enormous impact that capitalism is having on the Chinese working class as it is sucked out of the countryside and into the teeming cities; or the plight of working families in Detroit USA, whose jobs, homes and dignity have been

swallowed whole by the impact of the credit crunch.

Mason's new book opens with his first hand description of Lehman's box-carrying employees exiting its New York headquarters on Monday, 15 September, two days after a Korean rescue bid failed and its share price had collapsed 85%.

Over the previous weekend US Treasury Secretary Hank Paulson had brought together a cabal of top bankers to persuade them to salvage Lehman's after its toxic assets brought the bank low. Persuaded they were not, and with the Fed's attention drawn towards preventing the imminent collapse of the insurance giant AIG, Lehman's was allowed to go under. The Fed had already been made to look a mug in March when it handed over \$30bn for worthless assets held by investment bank Bear Stearns to stop its failure. The Fed was going to hold the line this time and make the banks realise they would be allowed to fail.

Or rather it was and then again it wasn't.

AIG had underwritten \$447bn of debts of global companies. It really was too big to fail, one money manager warned: "Its collapse would be seen as close to an extinction level event as the financial markets have seen since the Great Depression. AIG does business with virtually every financial institution in the world."

So the US government paid £85bn for an 80% stake and Mason introduces a new American word to *Newsnight*

viewers – “conservatorship” – or nationalisation as we like to call it this side of the Pond, “the first day of state capitalism” as Mason notes, but far from the last.

The Lehmans and AIG crises led to a rout on the global share prices of other suspect banks. By Wednesday 17 September, over what turned out to be a toxic gin and tonic, Gordon Brown agreed for Lloyds to swallow up HBOS, while back in the US the last of the investment banks, Morgan Stanley and Goldman Sachs, prepared to merge

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with deposit based banks to survive.

But it was still way too little and by Thursday morning “policymakers of the world are staring into the abyss”. Inter-bank lending had dried up, with borrowing rates jumping tenfold while banks deposited money with the government overnight at zero percent interest rather than lend to banks which might collapse before they could pay it back. The cost of borrowing for non-financial firms shot up from 2% to 8%. Capitalism had suffered a cardiac arrest.

On Friday the Fed announced the broad details of a system-wide bail out costing upwards of \$700bn to restart capital’s heart. Having started the week refusing to spend \$30bn to save Lehmans to enforce the lesson of “moral hazard”, the US government ended the week by spending 20 times that, a figure that has risen a further 15 fold since then.

As Mason reports, the real lesson is “There always was a safety net. The giants of the financial system could gamble, lose everything and yet walk away solvent.”

1929 and all that

Mason describes these historic events with a fast-paced colourful prose that matches the speed and drama of the events. He details the attempt by Paulson and Fed chief Bernanke to push the TARP bail-out package through Congress. These men were followers of Milton Friedman, who argued that the cure of big government intervention in the 1930s to counter the Great Depression was worse than the ailment.

While they were not about to curtail credit, the mistake made after 1929, they favoured a free market solution to the crisis as far as possible. Their ideological stubbornness backfired badly. Mason describes how the country-wide mass grass roots revolt to the rescue plan – from the right and left of the political spectrum – ensured Congress vetoed it.

“The something-for-nothing principle on which the original TARP was based looked outrageous to small town, fiscally conservative America; the determination to pay

above market prices looked like a scam. The determination to leave Wall Street free to pay extravagant bonuses . . . convinced millions of people that the US government had lost the plot.”

Gordon Brown reacted with equal timidity to the deepening crisis of the UK banking system in October. UK banks were not as exposed to toxic sub-prime assets as their US counterparts but were more heavily reliant upon short term money markets for funds to finance their business. These dried up as money fled UK banks. They were hit by a scissors crisis. As their shares fell, the value of their assets and capital reserves were depleted; they hoarded cash to meet legal limits on capital reserves as a proportion of their assets by cutting lending, so raising borrowing costs, so reducing the value of their shares, encouraging hoarding and so on – spreading the pain throughout the economy.

Labour promised £400bn in loan guarantees to the banks and took a non-controlling stake in banks. Mason shows how New Labour struggled to shake off its neoliberal dogma even in the midst of the crisis. Action was taken but, “it had always been done late, and without belief. It was as if the politicians and central bankers could never quite believe the crisis was bad enough to junk their old ideology.”

Nonetheless by mid-October the crisis was so bad that the banking system was part nationalised, Britain led the way and in November Paulson effectively nationalised what had been the world’s largest bank, Citigroup.

Across the globe, government bank bail-outs may have cost \$12-15tn, much of it in the form of credit guarantees. Bad debt write-offs to date amount to well in excess of \$1.1tn and counting. Before the crisis is over the bill will be in excess of \$2tn.

In less than a year the total value of traded shares fell from \$63tn to \$31tn, a sum equal to a quarter of the world’s financial wealth. The effect on industrial and non-financial services output is only beginning to be felt. At the very least, world GDP will slump from an average of 5% annual growth a year, to close to zero in 2009, an unprecedented fall caused by the seizing up of credit and the deflation of the debt mountain in North America and Europe.

De-regulation and derivatives

The rest of the book describes the slow burning fuse of deregulation, risk-taking and financial innovation that brought the capitalist world to the brink of meltdown.

In 1999 as President Clinton was about to leave office he signed the Gramm-Leach-Bliley Act into law, which Mason says merely “made official what the banking industry had been doing for a decade: merging, modernising, becoming complex, bending and twisting to get around outmoded rules.” In the same year the Gramm-backed Commodity Futures Modernisation Act was nodded through the Senate. This legislation enshrined “deregulated investment banking, expanded subprime mortgage lending to the poor and ethnic minorities, a planet-sized derivatives market and the fusion of banking and insurance.”

Mason describes in detail all the elements that were to lead to disaster: the destruction of the post-Depression

system of regulations that limited speculation and had imposed supervision; the rise of new share trading technologies that led to automated models that excluded possibilities of crisis and so amplified risk-taking; the wave of post-Stalinist privatisations in the 1990s which massively multiplied the global pool of available capital for investment banks to play with; the failure of the ratings agencies; the rise of off-balance sheet accounting (mal-)practices which hid debts; the abolition of exchange controls which led to huge rise in speculative currency trading; and of course the expansion of the derivatives market.

This market grew 80% from June 2006 to December 2007 (to \$596tn). Ten percent of that figure were credit default swaps, unheard of in 2000 yet – on the eve of the crash – worth not far short of the value of global GDP in 2007.

Mason gives a lucid explanation of the key developments that led to the credit crunch. He pays particular attention to the growth of “global imbalances” between the high savings countries like China and the huge debtor nations like the USA. The channelling of capital from the former to the latter provided a vast pool for the investment funds to operate with.

He also explains in detail the emergence of the shadow banking system, with hedge funds at the centre of it. These funds were a creation of the main investment banks and were designed to get around the strict controls on capital reserves (which restrict lending) that are at the heart of the official banking system.

He provides an excellent account of the development of subprime mortgage market, which took off early in the 2000s as Wall Street demanded a replacement for the failed dot com market, as a source of high-risk (and hence high returns) lending, and then successfully shifts our attention to the rise and fall of neo-liberal ideology as “the product of history and class struggle”. Specifically, “it was achieved through class struggle by the rich against the poor.”

The rise of neo-liberalism

Mason recounts how the heavily state-managed mixed economy of the US after World War Two engineered the “greatest economic boom in history”, which saw inequality diminish and living standards rise. He insists that the “central fact” of this boom was that “it was the outcome of class struggle”, as “working class parties had demanded a commitment to the welfare state, union rights and full employment.”

He charts the rise of the neo-liberal elite, including future Fed chairman Alan Greenspan and economist Milton Friedman from the 1950s, as they (at first unsuccessfully) battled against the post-war bipartisan consensus that strongly backed the mixed economy model. Only the onset of crisis in the early 1970s would thrust them centre stage. Their demands for reduction in welfare, for unleashing the free market, attracted adherents and in 1979-80 they found political expression in the election of Thatcher and Reagan in the UK and US respectively.

Mason documents the huge growth in inequality, insecurity and debt for the mass of workers on the one hand

and the redistribution of profits from industry to finance on the other. But he understands that the durability of an ideology and its broad acceptance rests on the “positive” sides of neo-liberalism: the lowering of absolute poverty, stability in capitalist growth patterns across the OECD between 1992 and 2007, the rise of women workers. In sum:

“This positive side of the balance sheet has been the course of neo-liberalism’s strength as an ideology: bor-

Starting around 1992, a new long cycle upswing can be discerned, a phenomenon this magazine has argued for on several occasions

row big time, negotiate your own salary, duck and dive, migrate if you have to, but lock your door at night. And let your hair down; they can treat you like shit at work but they cannot tell you who to sleep with or what time the pubs close any more.”

Mason outlines the closely overlapping elite of policy makers, bankers and industry magnates that form the global neo liberal elite, as well as the emergent coalition of globalisation critics and activists around former World Bank and IMF insiders such as Jeremy Sachs and Joseph Stiglitz.

Yet he cautions on two fronts: first, neither the anti-globalisation reformists nor the Marxist left saw the crisis coming in the form it was to take – an explosion in the financial markets tied to the housing market, leading to credit contraction and sharp recession. As he points out, this was simply not on the agenda of the Gleneagles G8 summit in 2005, neither for the elite inside nor the demonstrators outside. Second, the badly battered and discredited ideology of neoliberalism simply won’t lay down and die. It needs to be replaced by a coherent alternative in circumstances where “organised labour is in a dire state of weakness and fragmentation.”

“The disrupted wave”

This challenge leads to the book’s final, most novel, and perhaps most interesting chapter, “The Disrupted Wave”. Mason tries to position the credit crunch and the preceding developments in a longer time frame, that is to place the latest turn-of-the-century business cycle in a broader economic setting.

Mason situates the current crisis within the theory of long cycles or long waves, first developed by Nikolai Kondratiev in Stalin’s Soviet Union in the 1920s and 30s. For Kondratiev the cycles were of 50 years’ duration, divided roughly equally in half between a long upward phase and a downward phase. The upswing always coincides with the deployment of a key technology which helps to revolutionise production and underpins the upswing: factory steam engine in the early 19th century, succeeded in the

second half by railways, and the petrol engine and electricity in the early 20th century. Microprocessors were at the heart of the long economic boom after WW2.

By contrast, as the effects of these innovations diminish over time, a decline phase sets in when “interest rates fall, because the supply of capital is bigger than the demand for it; and agriculture suffers a prolonged fall in prices, while more power accrues to the banks.” Technological

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innovations are still a major feature of the downswing even though they cannot at this stage find broad application.

Mason uses this template to make the case for the revolutionising effect of internet technology and mobile telephony, beginning in the early 1990s, taking off steeply after 1997 and still ongoing. But he argues that according to Kondratiev’s schema the long capitalist down phase beginning in the mid-1970s (after the 1971-73 crisis), should have lasted well into the 1990s or the end of the decade. It didn’t.

Starting around 1992, a new long cycle upswing can be discerned, a phenomenon this magazine has argued for on several occasions. According to Kondratiev’s theory the 1990s should have been the phase of the downturn characterised by “massive financial crisis, a slump caused by overhanging debt, followed by a decade-long recession while the debt is paid off.” Instead “the Soviet Union collapsed and China went capitalist by decree, rapidly followed by the marketisation of India after 1991, suddenly the global relationship between capital and labour was massively tilted in favour of capital.” This, together with the expansion of credit and the roll-out of internet technologies, explains the “fifth K-Wave” for Mason.

He argues that Kondratiev’s theory was in part premised upon fixed exchange rates pegged to gold, which ended in the early 1970s, allowing the rise of fiat money – money based on credit – and policy manipulation of interest rate levels to such an extent in the 1990s that capitalist governments could smooth out dramatic cyclical fluctuations in prices and output that had characterised the post-war decades up to the early 1990s.

Mason does not give enough credit to Leon Trotsky for recognising that it was a mistake for Kondratiev to give his “stylised cycles” a priori definite fixed periods of upswing and downswing. Trotsky recognised the importance of internal or “endogenous” factors in undermining the long upward cycle, but insisted that the starting point for a new upswing after a downward phase could not be determined with the precision of calendar, but rather by the clashing imperatives of social-economic factors, such as wars, revolutions, conquest of new colonies and markets.

Indeed, as we have argued elsewhere, and as Mason acknowledges, the collapse of the non-capitalist third of the world into the arms of the capitalists provided a massive boost to capitalist growth and rising profits. In this sense the Kondratiev long down cycle was indeed cut short, but Mason goes further and interestingly argues that the eruption of the credit crunch with its features of financial shock and deep recession, typical of the latter part of a long downswing, indicate the long upswing too has been cut short, that there has been a considerable overlap of the last two cycles, an uneven combination of the features of the two.

For this reason the immediate future is unclear: “As a result the outcome of the 2008 financial crisis remains highly unpredictable; we have an ‘end of cycle’ crash combined with a technological revolution and the rise of a new kind of capitalism in East Asia.”

The future for capitalism

Mason ends his book with a discussion of what kind of capitalist growth models may emerge from the debris of the discredited über-neoliberalism of the last 30 years. He sees three possibilities: “the first is to revive the high-debt/low wage model under more controlled conditions.” This is the favoured position of the main capitalist governments. It entails an incremental retreat from the excesses of the system but no fundamental overhaul in property rights. Without a major eruption of class struggle from below forcing more radical solutions upon our rulers this seems the most likely outcome.

The second solution “embraces the end of the high growth, high consumption economy: if it can’t be driven by wages, debt or public spending then it can’t exist. And if it can’t exist in the west then Asia’s model of high exports and high savings does not work either.” In which case Mason suggests the low, or no-growth options of the radical environmentalists may – in conditions of growing awareness of the perils of climate change – provide an alternative, but only for the developed world.

This is too one-sided. There is no reason in itself why a complete reconfiguration of the model of growth in China – stressing growth of internal demand and investment, allied to welfarism could not release locked up “savings” and put them at the service of profitable domestic investment. This in turn would provide new export markets for the developed world. It is the much vaunted “global re-balancing” that many economists such as Martin Wolf and Stephen Roach, have preached for a decade or more.

This does not necessarily imply low growth and it is not incompatible with a green technology investment for China or anywhere else. Obama’s economic recovery programme as well as many other G20 government programmes, have set aside considerable amounts of cash for green investments. Some even fear that green technologies may become the next focus for an asset bubble in the next business cycle.

The problem is that its realisation requires a massive political struggle and shift in the balance of class forces, not only within China but between it and the US/EU. The consequences of such a shift would necessarily mean a

major change in the global balance of economic and, inevitably, political-military power.

The third option for Mason, “transcends the limitations of both Keynesian and neoliberal models.” It is a scenario based on the work of US economist Hyman Minsky who stressed the inevitable, crisis-ridden nature of the capitalist financial system. His work on the various phases of speculation and credit in the upward phase of the business cycle – stressing the growth of asset bubbles and their inevitable bursting – has added pertinence to the current situation. His solution was full-scale socialisation of the banking and insurance sector with laws to decrease inequality and limit speculative finance. As Mason stresses, this “was Minsky’s prescription to rescue capitalism, not to destroy it.”

Moreover, while the various G20 governments may have pragmatically cherry-picked bits of Minsky’s policies in an emergency, they are extremely reluctant to embrace the full package with all that it implies for a lasting recalibration of the power and wealth of classes in capitalist society.

Mason sees the most likely outcome from the current turmoil being a form of the first option. Bankers he is in close contact with are resigned to a much higher degree of regulation, of building up capital reserves and bringing all their debts back on their balance sheets. This adds up to one thing and one thing only: permanently depressed profit levels for the financial sector. As he says: “It’s uncharted territory for the bankers but, actually, we have a long experience of what happens when companies cannot make money, but form a natural monopoly and are essential to the functioning of the rest of business. They are called utilities.”

Mason aligns himself with a full-blown Minsky solution to the current crisis. “The Minsky alternative – a socialised banking system plus redistribution – is, I believe the ground on which the most radical of the capitalist re-regulators will coalesce with social justice activists. It is certainly more attractive to me than a reversion to low growth, decades of debt-imposed stagnation, or another re-run of the crisis a few years down the line.”

He argues that such a wholesale revamp of capitalism would be similar to the impositions of the Factory Acts in the early 19th century in England. Many predicted they would spell the end of capitalism, but in fact they help propel it into a new phase of growth. Allied to the upsurge underway in information technologies Mason thinks this could happen this time.

But if it were to happen then “the key players” will have to be the world’s working poor. He predicts, “organised labour looks set for a comeback” and if that happens then its goals will have to be set very high. “The outcome of the crisis will be shaped by the willingness of ordinary people to impose limits, standards and sustainability on capital – and the willingness of the state to take control where market forces lead to disaster.”

This crisis has discredited not only neo-liberalism but capitalism itself. The lexicon of socialism has resurfaced and is being taken seriously again

It is a pity that Mason limits his own ambition to a retooled mixed economy. It is not clear what his objections would be to a full-scale take over of all capitalist property rights, not just in banking. Does he believe, like Minsky, that the market for non-financial services and industry can be regulated to avoid crises of over-production and profitability? Or like Minsky that capitalist entrepreneurs are the best guarantee of innovation and should be free to operate?

If the decision on profit margins and product design is good enough to be in the hands of the state when it comes to finance, then why not investment and consumer goods? And if “ordinary people” are essential to realising such major transformations of the way capital works, why stop half way? Why not prevent their exploitation all together?

It is not just banking that needs to be turned into a utility but the functioning of the whole economy. Capitalist anarchy and crisis can only be countermanded by socialist democracy and planning. And for that the state that stands behind it needs to be ruthlessly taken apart and rebuilt anew from the ground up by a revitalised labour movement that rediscovers its revolutionary traditions.

This crisis has discredited not only neo-liberalism but capitalism itself. The lexicon of socialism has resurfaced and is being taken seriously again. Mason’s book does a good job of showing why.