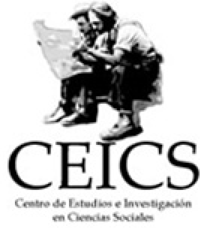

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The Bubbles, the Bottomless Risks, and the Big Financial Crunch: The U.S. Financial Crisis and Its Worldwide Transmission

An Interview with Cyrus Bina (University of Minnesota, USA)

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QUESTION #1: In your opinion, what are the actual magnitude and perspectives of the current economic crisis?

ANSWER #1:

The present economic crisis is both unique and universal. It is unique in that it expresses concrete contradictory dynamics of capital accumulation and its manifold contingent effects that are violently overflowing from one sector of the economy, namely *subprime* mortgage industry in the United State, through the so-called *structured investment vehicles* and *hedge funds*—which ultimately fed into the new infectious domain of fictitious capital, known as "securitization"—to the remaining realm of economic activity worldwide. Here, the concrete magnitude of the crisis is not only a new chapter in *actual* history of modern capitalism but also speaks loudly on the real meaning of transnationalization of capital and its global transmission in today's interconnected world. This crisis is immanently universal in its effects and in its manifestation. It is about the polarization of wealth and, by implication, the polarization of class, and the

simultaneous tendency toward *inter*national and *intra*national dissonance, and thus worldwide standardization of the working class. The common feature of the system, aside from hitherto evolutionary stages, is one of renewal and destructive creation.

Although there had been a number of avoidable circumstances in this debacle—for instance, careful regulation of the subprime housing market or precise legal guideline for "securitization" of risky financial assets—the bundling of the "Collateralized Debt Obligation" with the so-called Asset Backed Commercial Paper, which leads to awesome turnover of capital based on ad hoc creation of fictitious credit upon fictitious credit for the purpose of rapid profit gains and little or no cushion for security, thus jeopardizing the safety of entire financial system. By focusing on a handful of world's largest banks—from U.S. investment banks, such as UBS, Merrill Lynch, Citigroup, HSBC, Morgan Stanley to IKB Duetsche, Credit Agricole, Credit Suisse, Deutsche Bank, Canadian imperial, Societe General—one can clearly see that the write-downs of risky securities are so far in tens of billions of dollars and will certainly continue for quite sometime. In the first quarter of 2008, the profit of big investment banks on stocks, bonds, and syndicated loans tumbled by more than 45%.

This experience has now opened a revealing window to the fully developed concept of *fictitious capital*, a phenomenon that in its embryonic stage was identified by Marx nearly 150 years ago. Today, the role of "fictitious capital" is either confused with the source of surplus value or worse, deemed (axiomatically) as "phony," "unnecessary," or "superfluous" in respect to the actual process of capital accumulation even by certain self-proclaimed Marxian economists. Yet, such an interpretation overlooks the reality of quasi-cannibalistic tendency of capitalist competition associated with the accumulation of capital. This criticism is also relevant to those who draw a parallel between age of the pre-globalized capital, classical trusts, and administrative pricing (i.e., the early internationalization of finance capital á la Hilferding and/or Lenin,), and that of the contemporary globalization. Moreover, the traditional left uncritically speaks of the so-called primacy of finance, thus invoking rather anachronistically the political and economic descriptions that are unfit to present epoch.

Finally, some of these critics have neither the necessary methodological training nor instinctive imagination to look at the economic crises in holistic manner, thus

commencing with capital as an undivided whole (i.e., as a social relation) before attempting to examine its unavoidable division into commodity, money, and productive forms. For instance, in my opinion, "financialization"—currently a vogue term used by left-leaning heterodox economists—tends to veil the intrinsic roots volatility in the accumulation of capital and attribute it to its form.

This, as I have long contended, retreats from the reality of the workings of the law of value in the age of hypercompetitive globalization. I believe "financialization" is a side-track that obfuscates the desperate attempt at preservation of value in the sphere of circulation; this often leads to the weapon of competition in terms of shenanigans that we are rather painfully witnessing in the course of present crisis. Today's economic crisis (and its very glimpse in terms of hyper-speculative activity) manifests itself acutely in the realm of finance in which tendency to stretch the preservation of value is matched by its fast-paced destruction in the production process. It is in this context that contradictions between and within the spheres of production and circulation render perceptible and, however discursively, come within the global view.

QUESTION #2: How is the crisis going to affect the United States? Which economies, do you think, are going to be the most affected in the short-run and in the medium-term?

ANSWER #2:

This crisis just like a hurricane first appeared in the U.S. subprime housing market and then gathered strength before reverberating throughout the financial system worldwide. The proverbial U.S. housing-market bubble has been waiting to be burst for a long time, as a number of keen observers, such as Dean Baker, had already forewarned, despite hollow optimism, if not shallow idealism, espoused by Alan Greenspan, former Chairman of the Federal Reserve—who did not even listen to some of his colleagues who warned him to that effect as early as 2001. The fallacy of supply-side economics and the myth of self-correcting markets, culminated in idealism of benign neglect, and the straightjacket practice of neoliberal ideology. The resultant speculative bubbles in the U.S. real estate, mortgage institutions, collateralized debt market, asset-backed

commercial paper market, and debt-obligation insurance market sequentially burst in the face of U.S. authorities, before they hit the public and surpass the boundaries of the United States—via the transnational channels.

The full consequence of this, for the U.S. economy and world economy as a whole, has not yet been realized, as the crisis is still unfolding. This is the classic sign of unfolding of an economic crisis from *potential* to *actual*, and as such the battle ground between the maintenance of value, on the one hand, and its wholesale destruction before the renewal of accumulation, on the other. This also speaks to the fragmented neoclassical economic orthodoxy (and its eclectic following in heterodox tradition), whose macroeconomic theory misconstrued through the fallacy of composition, thus falling back on the reduction of axiomatic micro counterparts (i.e., so-called micro-foundation) devoid of institutional significance. Today, therefore, we must recognize two different kinds of crises: (1) the periodic crisis of capitalism and (2) the intellectual crisis of bourgeois economics.

According to the International Monetary Fund (IMF), U.S. economy is predicted to grow not more than 0.5% and 1.6%, respectively, in 2008 and 2009. IMF, however, misses the point that this is not an ordinary recession, given the staggering default in the U.S. housing market, the augmented domino of derivatives in the financial system, the anticipation of further banking collapse, and inadequate policy action on the part of the Bush administration. The projected growth for Chinese and Indian economies is respectively at 9.3% and 7.9% in 2008, which would be below 11.4% and 9.2%, respectively, in 2007. This, of course, is apart from the creeping asset bubbles that are momentarily gaining strength in the Chinese financial market. The forecast for European growth, in 2008 and 2009, is somewhere around 1.4%, compare with 2.6% in 2007. Africa and Latin America are expected to maintain robust rates, yet disguised unemployment and creeping inflation in energy and food sectors are the likely occurrences. In the meantime, the global growth is likely to weaken somewhere between 3.5% and 3.7%, from 5% and 4.9, respectively, in 2006 and 2007.

European Union is now trying to deal with the aftereffect of U.S. financial debacle. European banks attempted to write down more than $200 billion of debt obligation, following the U.S. mortgage defaults, thus revealing the tiny tip of the

liquidity crisis in the view of tight credit market. To date, the write-downs for a few major banks in Germany and Switzerland are some $23 billion, and they certainly will increase by the time the dust settles.

QUESTION #3: In your opinion, how effective the ongoing economic stimulus, such as decrease in the interest rate, will be in preventing the economy from slipping into recession?

ANSWER #3:

There is no question that the U.S. economy is now in the recession. The added danger, however, is the banking crisis in the midst of the collapse. On the top of all this, there is a considerable decline in the value of U.S. dollar relative to other global currencies. This decline is persistent and its magnitude is consistently reflective of a significant increase in prices of gold, metals, crude oil, and basic staples—to name a few. The U.S. economy is sneezing in cold sweat but at this time—notwithstanding the financial contagion—world economy is not even uttering: “bless you.” Here is the belated distinction between the transnationalization and the so-called Americanization in respect to today’s global economy—and, by implication, the defunct American hegemony. This crisis is the symptomatic of the need for clear distinction between the ideology of neo-liberalism (and thus neoliberal policies espoused by the U.S. government and its so-called Western allies) and epochal meaning of globalization as an all-encompassing structure, beyond the conventional notion of imperialism and/or nationalism. With this preamble, we now focus on some concrete issues.

The U.S. government proposal for refinancing U.S. mortgages falls somewhere between $300 billion and $400 billion. The Federal Reserve has already extended $30 billion to bailout Bear Stearns (fifth biggest investment bank), which had about $33 debt for every $1 of assets it held. Wachovia, the forth largest U.S. investment bank, is also on the tattering edge of unexpected loss. Write-downs in Merrill Lynch amounted to $9.7 billion dollars in conjunction with 4,000 layoffs just in the first quarter of 2008.

The Federal Reserve extended emergency loans to major Wall Street investment banks. The Fed also offered $200 billion in Treasury securities to a select number of investment banks, known as "primary dealers," that are regularly party to its open-market operation. What are the collaterals in certain of these cases? They are hard-to-sell, privately issues, risky mortgage-backed securities that for all intents and purposes would not worth the paper they were written on. U.S. subprime mortgages are about 21% of the total. Defaults in this segment of the market have led to potential default of the mortgage-holding institutions and, in due course, to the underwriters of the asset-backed commercial papers that had insured the amalgam of these collateral risks in the fist place.

All this has come in a full circle, first leading to a substantial decline in the home prices across the board, which translated into instant devaluation and thus evaporation of equity all over the place, and then passed on and spread to the layered network of financial institutions that reluctantly had to write-down hundreds of billions of dollars on their books. U.S. financial system faces potential losses of well over $1,000 billion as a result of credit crisis. Hence, *credit crunch* in the form in which this particular financial crisis manifests itself here in the U.S. and throughout the globe. Finally, the market for real-estate is now beginning to exhibit its universal effects on vanishing equity around the globe, from Ireland to India.

To treat the symptom of the crisis, namely the subsequent "credit crunch," the Federal Reserve, under Ben Bernanke, cut the federal fund rate 6 consecutive times, from 5.25% to 2.25% by March 18, 2008—a substantial reduction of nearly 60%. One might be reminded that further reduction in the discount rate toward the vicinity of 1% (i.e., similar in 2004 under Greenspan) should scare any economist who has written a dissertation worth the paper written on. The unintended consequence can be the lack of interest-elasticity of investment and ineffectual monetary policy—which, in addition to the ongoing credit crisis and banking debacle, are the stuff of the Great Depression. On the face of this, the Bush administration extended a $168 billion stimulus tax-rebate in order to beef-up the consumer spending. This package, which is too little and too late, does not even extend the duration of unemployment insurance, from presently six months to, say, a year, in order to cushion the massive layoffs that are now beginning to have effect across the American economic landscape.

On the financial side, the new Treasury Department plan, the hallmark of which is the merger of Securities and Exchange Commission and Commodity Futures Trading Commission, is designed to primarily overhaul the competitiveness of the financial system by focusing on Wall Street institutional investors rather than the well-being of the system as a whole, including the Main Street investors. Moreover, this plan is neither a measured prescription for safeguarding the dominos associated with limitless fabrication and multiplication of risks nor a deliberate remedy for regulating the epidemic distribution of derivatives and their contagion across the global financial system nor even an immediate response to the current crisis in which a huge number of ordinary people will certainly go under, one way or the other.

QUESTION # 4: How is the crisis going to result in the magnitude of petroleum prices? Will the prices keep growing?

ANSWER #4:

The transmission of subprime crisis in the housing market has resulted in default in the mortgage market and then through the collateralized asset market wreaked havoc with the underwriters of such amalgamated risky debt obligations in one sweep. The forced write-downs of these assets in the investment banking sector, on the one hand, and the slowdown in the pace of economic activity, on the other hand, stirred the U.S. economy toward recession. At the same time, the continuous decline of U.S. dollar, since 2002, against euro and other significant international currencies revealed the structural shift and moribund status of the United States relative to what it used to be under the *Pax Americana*. In the last meeting of Global Economic Forum at Davos, Switzerland, even sympathetic liberals and social democrats realized, rather belatedly, that the American economy is no longer functioning as the engine of world economy. Their lexicon was "decoupling," signaling rather aptly what I have already foreseen, despite the pageantry of Reaganomics and pomposity of "the only superpower," well over two decades ago.

Meanwhile, Chairman of the Federal Reserve, Ben Bernanke, responded to the crisis (i.e., what is manifested as credit crunch) by cutting the short-term (discount)

interest rate, thus discouraging the inflow of portfolio investments, curtailing the demand for dollar, and consequently furthering the decline in the value of U.S. currency. Fearful investors seeking shelter pushed the price of Gold above $1,000 an ounce, registering yet another decline in the value of U.S. dollar. An increase in the price of metals, more or less, followed the same mechanism, thus created tendency for bubbles in the market for these commodities. The price of agricultural products (food) has also increased, in part due to the heightened global demand and, in part because of the competition of food and fuel—thanks to ethanol hype—that is now being recklessly promoted by the populist governments and self-promoting interest groups in both the United States and Latin America. Food crisis has already manifested itself in a number of food riots around the globe, from Bangladesh to Haiti.

Finally, the global oil value—the long-run center of gravity around which the market fluctuations tend to gravitate—has been set based upon the highest cost oil region, i.e., the USA. However, the $115-plus oil and what is driving the price globally have something to do with a combination of factors: (1) continued demand from the United States (4.5% of world population consumes 25% of world's oil consumption), plus increasing global demand, including China (with double-digit growth rate), and, somewhat similarly, India along the rest of growing developing countries; (2) tendency for speculation and derive for asset-holding activities; (3) sizeable decline in the value of denominating currency, the U.S. dollar; (4) political events of relevant significance. Decline in the value of U.S. dollar gives rise to two separate effects in the price oil: (a) direct effect via the nominal value of oil in dollar and (b) indirect effect via flight from dollar to oil due to speculative asset-holding or exchange value. The impending global recession, of course, will have *ceteris paribus* a moderating effect on demand thus a possibility of moderation in price in real terms. However, flight from dollar does not readily lend itself to a predictable outcome, due to its uncertain speculative nature.

QUESTION #5: Since oil is an essential input to the production of a great number of products, what could happen if the price of oil keep growing as the U.S. economy slows?

How much of the actual problems in the US industry are consequences of the high petroleum prices?

ANSWER #5:

Crude oil, its most significant joint-product, natural gas, and its manifold derivatives, such as gasoline, jet fuel, home-heating oil, etc., are not only constituent components of the energy sector as a whole but also inputs to essentially a whole host of production processes that are defining the bulk of production worldwide. Yet, it would be a grave mistake to focus exclusively on the *use-value* of crude oil. For, while the physical (input-output aspect) and thus material requisite of oil is necessary, it is by no means sufficient to speak of oil as a commodity without focusing on its *exchange-value*, i.e., its value formation and thus price determination in conjunction with the social dimension of value. In other words, the same processes that obtain their negative impact from increasing price, soon or late, tend to adapt to the situation by reinventing the production process and cutting demand, much like the adaptability of biological species in nature. However, we must be careful not to label as natural but social, at the very heart of which lies within the historically specific socioeconomic system.

Therefore—by focusing on dynamic interactions of economy as a whole—the fact that the price of oil is increasing beyond the expectation of the public is itself an indicator of sorts for the primary influence of the turbulent economy and not the other way around. In other words, it is not only utterly false to replicate the textbook message of supply-side economics that "supply shocks" (i.e., the oil crises since the 1970s) are responsible for past U.S. recessions, thus reversing the direction of causality, but also misleading the public as to the physical (i.e., external), and not social (i.e., internal), origin of economic crises.

To be sure, in a grand loop of dynamic interaction the $115-plus oil will undoubtedly reinforce the decline of the U.S. economy and, for that matter, world economy toward deep recession. Consequently, if we draw a parallel between the present economic crisis (respectively, in the U.S. and the world) and the gravitational fields in astrophysics, we may be able to perceive how the quantitative result of oil price hike, which itself is an outcome of the dynamics of world economy, in turn obtains its effect on

the gravitational field of the latter. Hence, the prognosis of both the right (i.e., orthodoxy), and the liberal/radical left (i.e., self-proclaimed "heterodoxy") does not seem to hold water in this case. The significance of high oil prices is, therefore, inseparable from the dire need for reorganization, if not restructuring, of the U.S. and world economy via the present crisis.

QUESTION #6: How is the crisis going to affect the oil producing countries, such as Venezuela?

ANSWER #6:

The present crisis is multidimensional, thus its impact are wide-ranging and varying from country to country. Oil exporting countries, particularly the developing countries with a relatively sizable population (such as Iran and Venezuela), are potentially subject to high food prices, which would translate to the loss of sizable foreign exchange due to importation of basic staples, such as corn, rice, wheat, etc. Prices of other food items that are dependent on these commodities are also expected to rise. This situation is in part due to a new U.S. phenomenon (i.e., production of fuel from corn, etc.), which is ostensibly motivated by the fiction of energy self-sufficiency and fabrication of the so-called "national security," which then unwisely adapted by countries like Brazil—despite the apparent double-injury reflected in the high price of food and inexhaustible source of pollution against the environment—and implication for global warming. Hence potential crisis is on the horizon through the competition of food and fuel.

On the other hand, high price of crude oil can be translated into added oil revenue for exporting countries, such as Iran or Venezuela. This may offset the negative effect of high food prices in these countries. Yet, due to a significant decline in the value of U.S. dollar—the denominating currency—the real price of oil is not as high as it appears, which in turn speaks to the real level of oil revenues of the exporting countries, such as Venezuela and Iran. This is particularly significant for Iran and Venezuela, whose respective governments do not see eye to eye with the Bush administration (particularly,

in the case of the latter that is under sever embargo), whose bulk of foreign exchange may be in euro or if in U.S. dollar does not entirely lend itself to shopping spree in the U.S. goods market.

To all this, we may add another moderating factor that emerges from the impact of impending global recession and its corresponding moderating influence on the worldwide demand for oil. Thus, in the final analysis, in the absence of structural change and the persistence of the center of gravity (of production), change in the price of oil (and exporting countries' oil revenues) is subject to the complex set of contradictory factors that are spelled out above.

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Minnesota, USA