

THE GLOBAL FINANCIAL CRISIS: CAUSES. BAIL-OUT. FUTURE.

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Causes of the Collapse

- The Minsky Moment
- Minsky's Stages
 - Money Manager Capitalism
- Financialization, Layering, Liquidity
- Fraud and the Real Estate Bubble
- Shredding of New Deal Reforms
- Bubbles, Goldilocks and Budgets

Minsky Moment

- Financial Instability Hypothesis
- Investment Theory of the Cycle and Financial Theory of Investment
- Hedge → Speculative → Ponzi
- Big Bank and Big Government Rescue
- Stability is Destabilizing

Boom and Bust

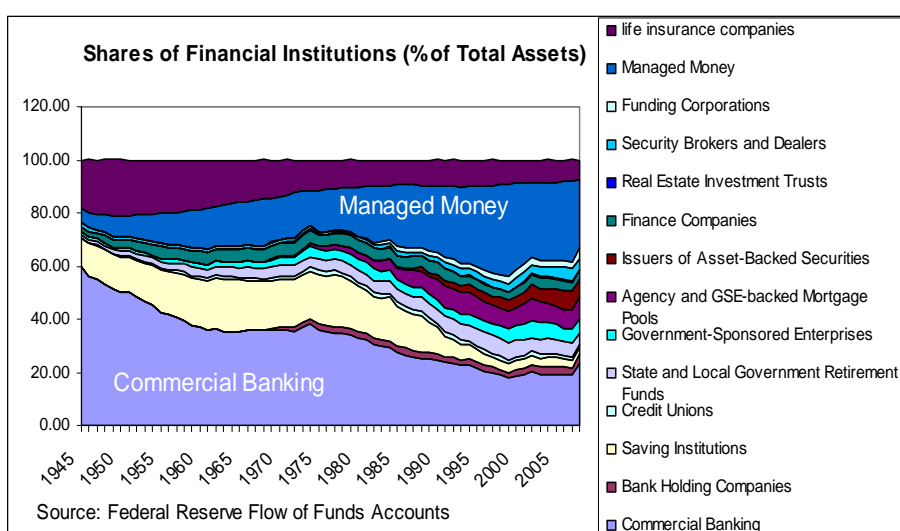
- 1980s Thrift & Bank Crises
 - Thrifts and Commercial real estate
 - Banks and LDC debt
- 1980s Leverage Buy-outs
 - Michael Milken and Junk Bonds
- 1990s New Economy and Nasdaq
 - “Irrational Exuberance”
- 2000s Residential Real Estate
 - Subprimes; foreclosures
- 2000s Commodity Markets
 - Quadrupled oil prices; food riots; starvation

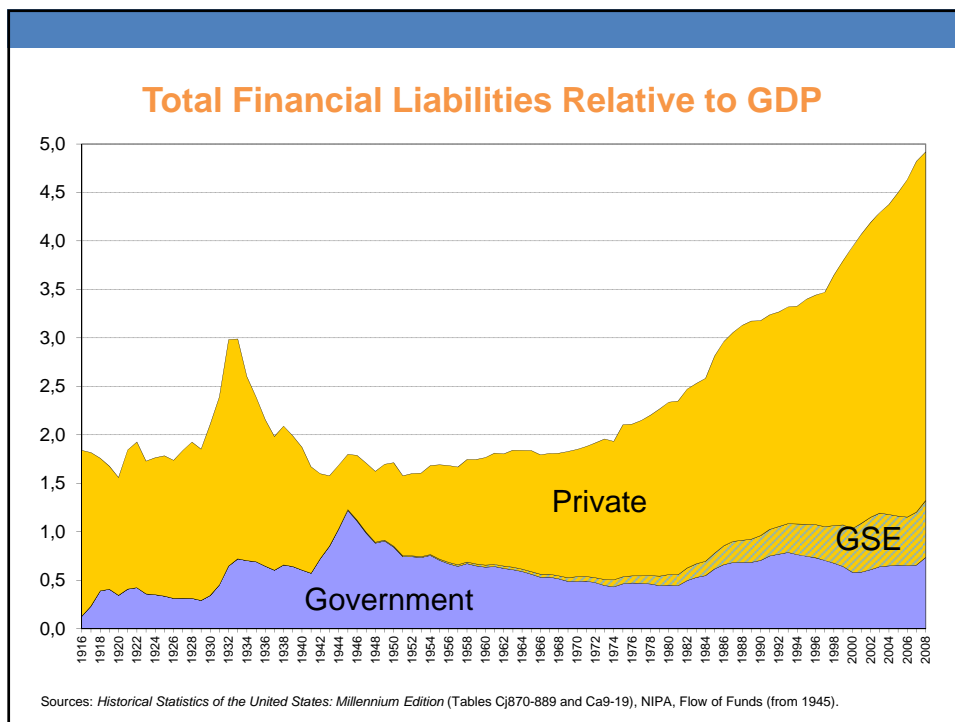
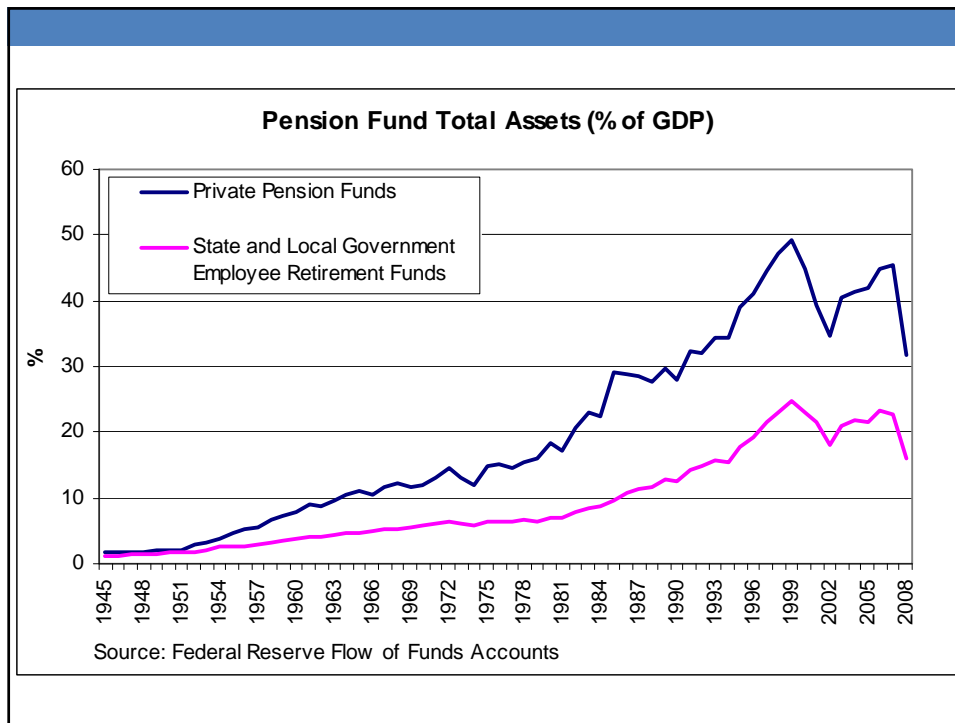
Each follows the pattern and each crisis is worse than the previous

A Minsky Half-Century?

- Stages Approach: 57 Varieties
 - Commercial capitalism
 - Finance capitalism
 - Paternalistic (Managerial-Welfare State) capitalism
 - Money Manager capitalism (predator state, financialization, ownership society, neoliberalism, neoconservatism, shadow banking)
 - Stability bred instability
 - Accumulation of financial assets/liabilities
 - Globalization
 - Securitization
 - Self-supervision

Decreasing Weight of the Banking Sector



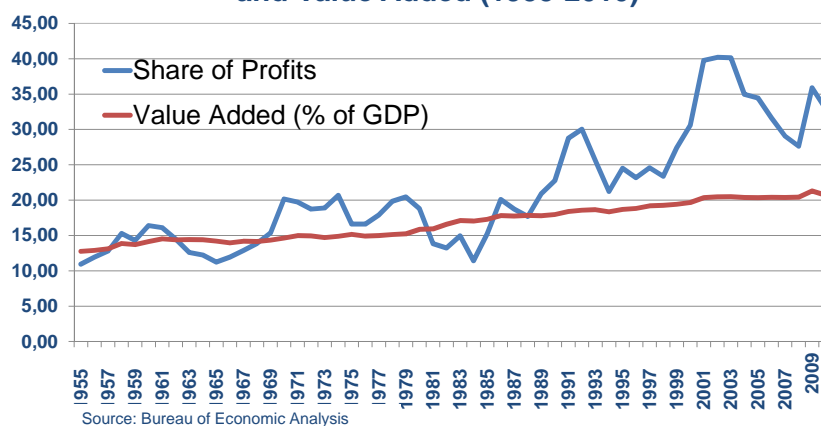


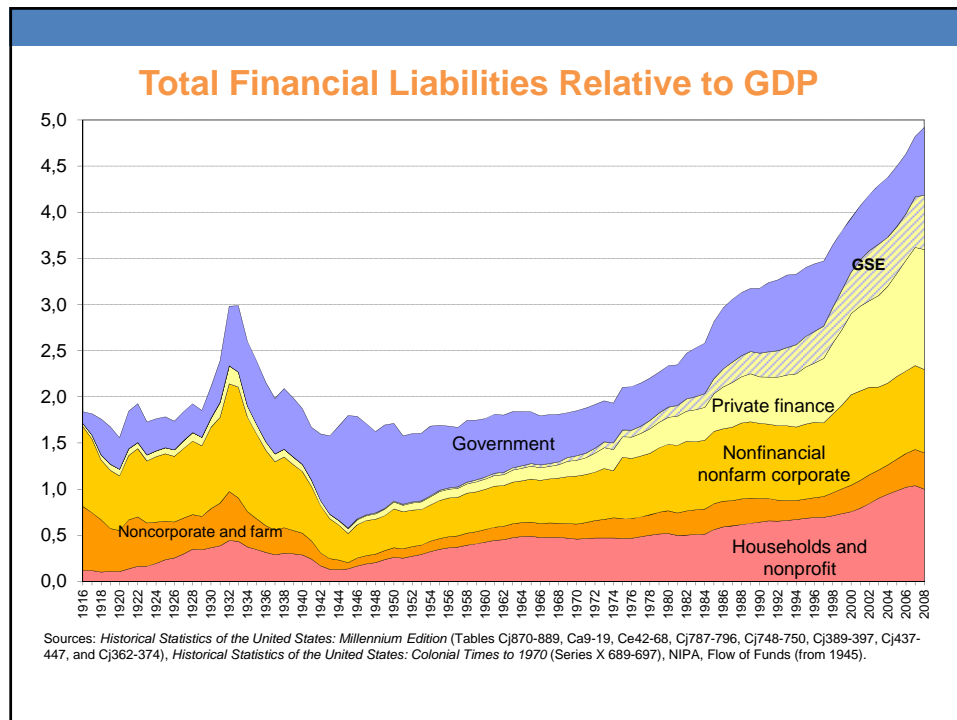
Financialization, Layering, Liquidity

- Rising share of profits and value added going to financial sector.
- Layering debt on debt on debt.
- Positions in assets financed through very short term (overnight) borrowing.
- Casino-like speculation dominates.

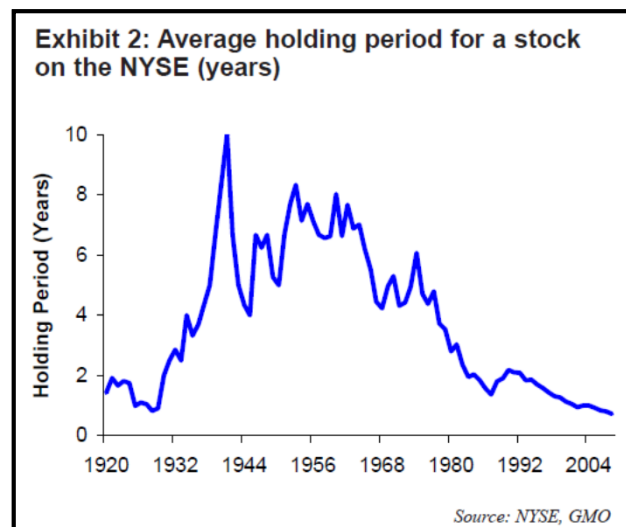
Financialization of the U.S. Economy

Financial Industry Share of Corporate Profits and Value Added (1955-2010)





Keynes: When speculation dominates enterprise the job is likely to be ill-done



Real Estate Bubble and Fraud

- Like Shrek's onion: Every link in the Home Finance Food Chain was fraudulent:
 - Appraisers, brokers, lenders, MERS recording, securitizers, trusts, accounting firms, ratings agencies, and servicers.
- Most fraud was on part of lenders.
- Fed recognized as early as 2000; FBI warned in 2004 "epidemic of fraud".
- Most foreclosures are fraudulent.

Securitization: The basis for leveraged bets

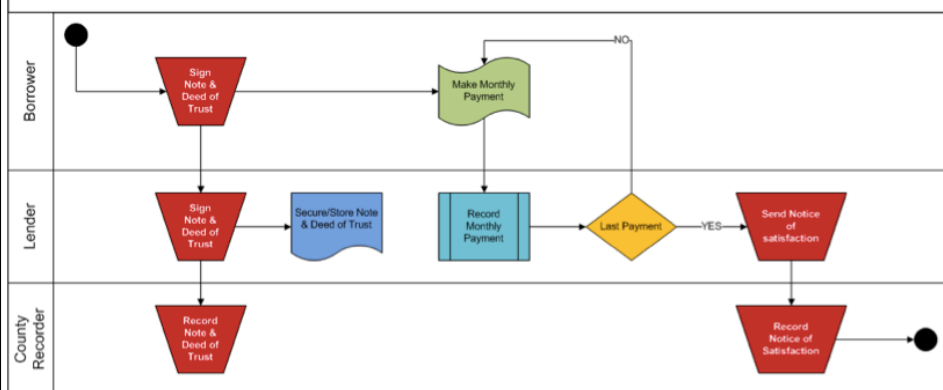
- Basic idea: pool a bunch of debt (i.e. mortgages) to act as collateral for securities.
 - **Why?** Insufficient sovereign debt.
- Payments on the debt used to pay the promised interest on securities.
- Can create series of tranches, with different "seniorities" of varying risk.
- Underwriting standards deteriorate:
 - Low doc → no doc → NINJA (don't ask, don't tell)

New Home Finance Model

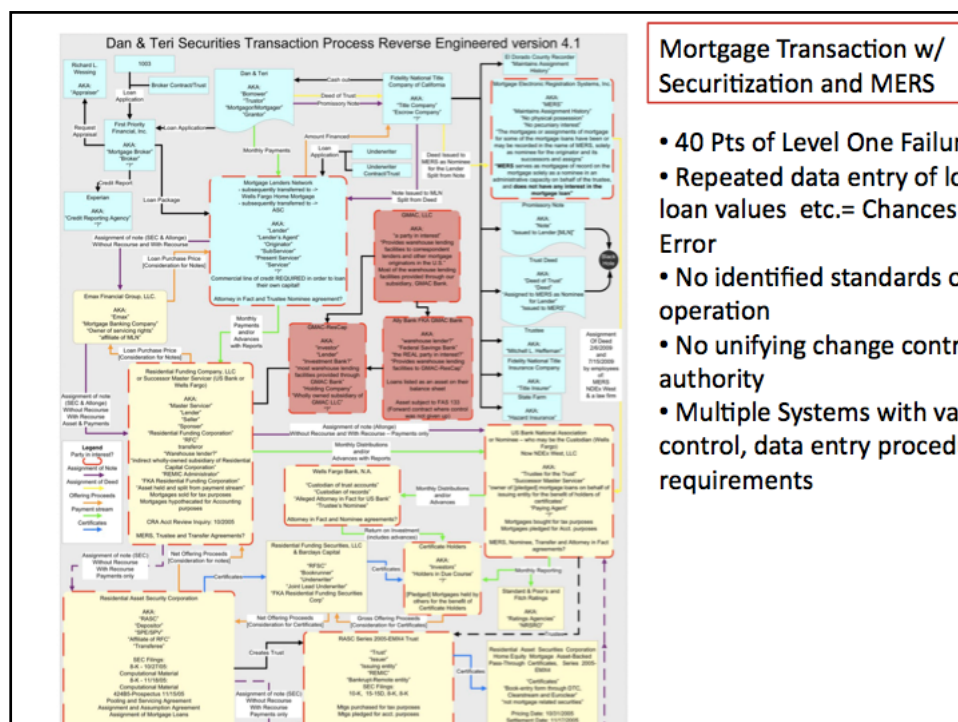
- Jimmy Stewart's Thrift: loan officer, bank teller, home appraiser; public recorder.
 - Loans held to maturity
- New more "efficient" Wall Street model:
 - Involves broker, appraiser, lender, servicer, MERS, securitizer, credit rater, rocket scientists and proprietary models, MBS trustee, CDOs squared and cubed, CDSs and monolines, investors, traders, accountants, lawyers, lender processing services; robo-signers, document "recovery" services (forgery).
 - Model: originate to distribute, pump and dump, foreclose and resell.
 - Capitalizing unrealizable home values.

Mortgage Transaction without Securitization or MERS

Pre-Securitization & Pre-MERS



** Sub process involving lender transfer of note and deed not shown.*



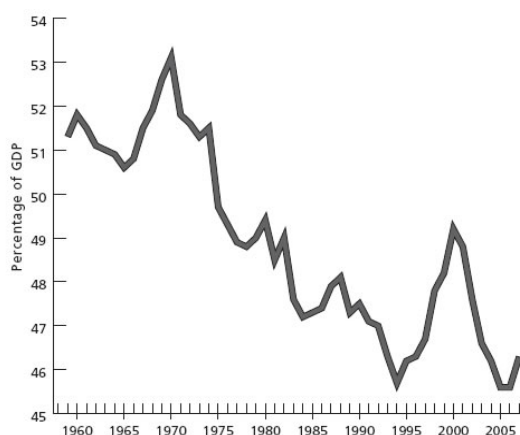
WHY??????????????

- Why the complexity and fraud at every layer?
- Model was flawed from beginning: could not have been profitable; interest payments could not cover costs,
 - Needed mortgages @ 100% or 120% of value to book fees,
- Complexity essential to hide accounting fraud.
- Everyone rewarded by through-put.
- The beauty of a Casino: the house always wins.
 - \$10T of homes → tens of trillions of dollars of bets.
- Foreclosure was inevitable, desired, outcome: bet on failure then reboot thru foreclosure and to hide the fraud.
- Like 1929 investment trusts.

Shredding of New Deal Reform

- Deregulation, desupervision, self-supervision
- Rising inequality
- Falling wage share
- Rising consumer debt

Wages and Salaries, % of GDP



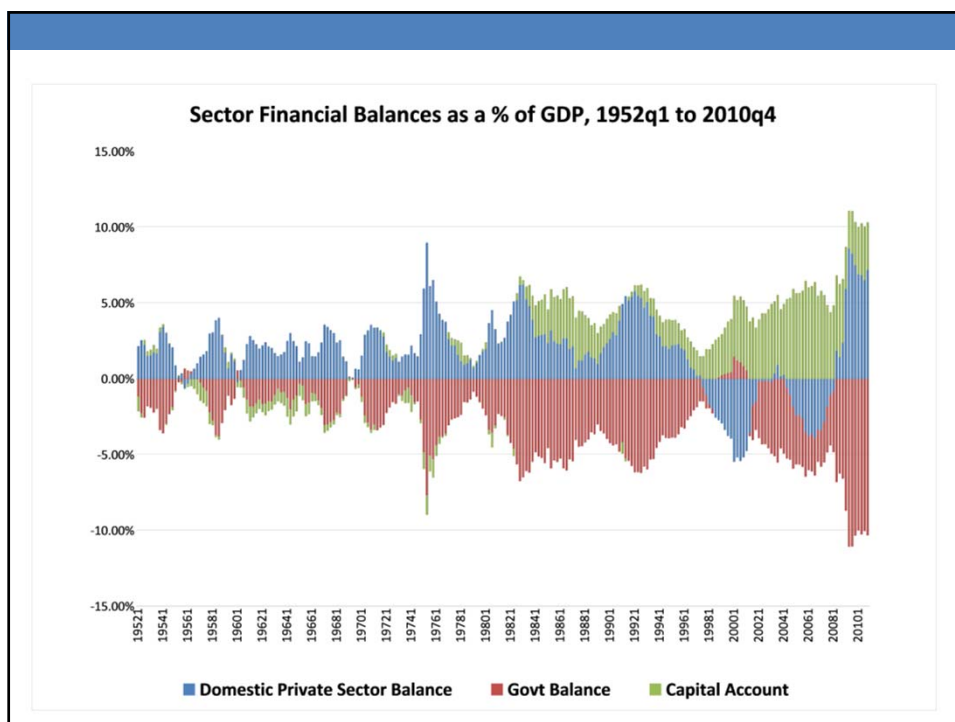
Financial Bubbles, Goldilocks and Budgets

- Bernanke and Great Moderation.
 - No bubbles in sight. Fundamentals are strong.
- Reality: biggest debt, equity, commodity, and real estate bubbles in history.
 - Financialization, Globalization, Neo-liberalism, Predator State, Money Manager Capitalism, Ownership Society.
 - Propped up by Big Government and Big Bank—No cleansing through debt deflation dynamics.

GFC 2007: It all started with Goldilocks

- 1996: US Federal Government begins surpluses; continued for 2.5 years.
- Clinton projects surpluses for next 15 years.
- All Government debt will be retired.
- Private debt explodes. Why? The Three Balances.
- The Meaning of Zero:

0=Private Balance + Government Balance + Foreign Balance



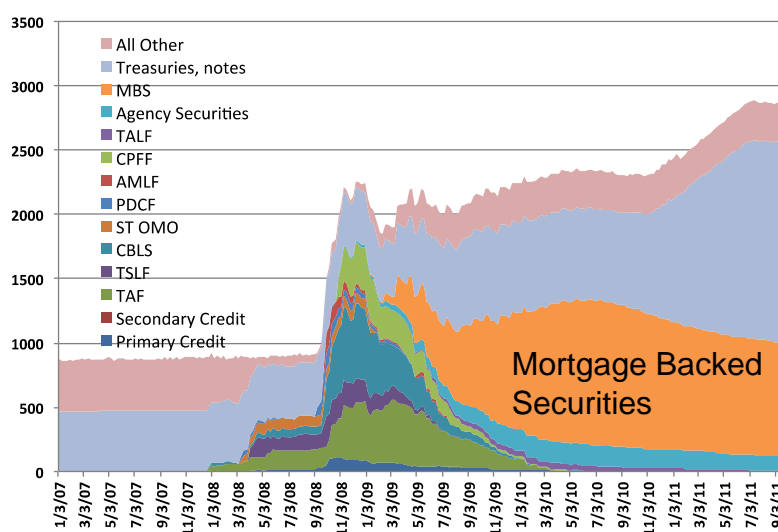
Bail-out and Cover-up

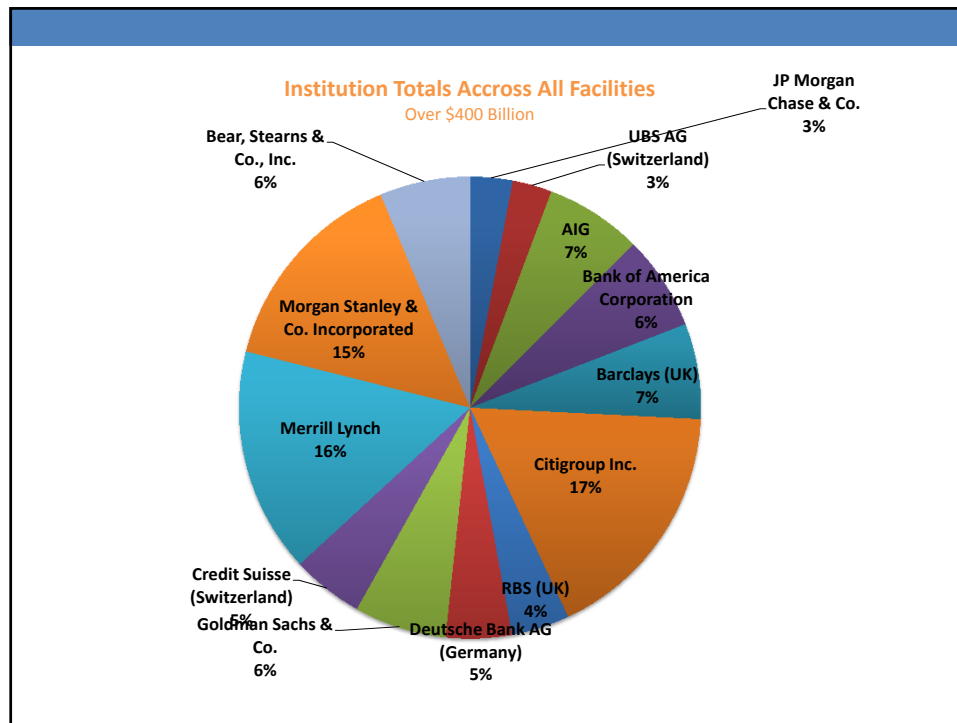
- No criminal prosecutions of top management.
- Stimulus \$800B.
- Hank Paulson \$800B.
- Fed: \$29 TRILLION.

Paulson/Geithner Plans: Trying to restore Money Manager Capitalism.



Select Fed Assets, 1/3/2007-9/2011





Summary: \$29,523,510,000,000

Conventional			Unconventional		
Facility	Total	Percentage	Facility	Total	Percentage
TAF	\$3,818.41	12.93%	CBLS	\$10,057.4	34.1%
TSLF/TOP	2,005.7	6.8	ST OMO	855	2.9
			PDCF	8,950.99	30.3
			Bear Stearns Bridge Loan	12.9	0.04
			Maiden Lane I	28.99	0.10
			Maiden Lane II	19.5	0.07
			Maiden Lane III	24.30	0.08
			AIG RCF	72.35	0.25
			AIG SBF	802.32	2.72
			AMLF	217.35	0.74
			CPFF	737.07	2.5
			TALF	71.09	0.24
			MBS	1,850.14	6.6
	\$5,824.12	19.7%		\$23,699.01	80.3%

Crimes multiply in the cover-up

- Burger King Kids: robo-signing, forgeries.
- Lost note affidavits, backdating docs.
- Lawyers: perjury in court.
- 13 million foreclosures by 2012.
- Homeownership rates already back to pre-boom level.
- Blood-sucking vampire squid hedge funds buying up blocks of homes, cents on the \$.

End Game for Money Manager Capitalism

- Euroland is toast; failure of major bank will set off GFC 2.0
- Radical euthansia: major banks will fail.
- Managed funds will fail: pensions, sovereign wealth funds, mutual funds, insurers, hedge funds.
 - That is a good thing!
- Minsky's "simplification" of the financial system.

End Game for Money Manager Capitalism

- Will emerge with little private debt, massive government debt → robust financial system; Constrained with new laws, supervision.
- Return to underwriting, hold to maturity.
- Financialization replaced with New Deal 2.0: Higher Wages, Full employment, Domestic Consumption.

THANK YOU

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