Goodbye Regulations, Hello Impending Global Financial Crisis

Prof.dr. Gerald Epstein

Ten years after the last financial crisis, Republicans — with backing from many Democrats — have made sure that Wall Street can return to its old ways of doing business by repealing the Dodd-Frank Act, which acted up to now as a very mild regulatory regime to rein in the predatory nature of financial capital. The decision to repeal Dodd-Frank was justified on the grounds that it put a break on economic growth. Gerald Epstein, professor of economics and co-director of the Political Economy Research Institute at the University of Massachusetts at Amherst, argues that this is not true at all. In this exclusive Truthout interview, Epstein notes that it is now very likely that the "toxic, speculative activities" of the Wall Street crowd will return with a menace, thereby preparing the groundwork for the next global financial crisis.

C.J. Polychroniou: Following the financial crisis of 2008, a bill was passed in 2010 under the Obama administration that sought to contain risks in the US financial system. The bill, which was sponsored by US Sen. Christopher Dodd and US Rep. Barney Frank, was rather weak as a regulatory regime. Nonetheless, it was severely criticized by conservatives. Donald Trump delivered a mixed message in running for president, railing against the big banks and Hillary Clinton's connections to Wall Street, while at the same time promising more deregulation. Now, Congress has passed and President Trump has signed into law a comprehensive financial deregulation law, "The Economic Growth, Regulatory Relief, and Consumer Protection Act." In addition, Trump-appointed financial

regulatory agencies such as the Securities and Exchange Commission (SEC) have implemented policies to loosen regulations further on a variety of financial institutions and activities. The backers of rolling back Dodd-Frank have claimed that financial deregulation will increase economic growth and provide more credit to households and business. First, what were the weaknesses of the Dodd-Frank Act, and did it actually contribute to anemic economic growth, as its Republican critics like Paul Ryan and others are arguing?

Gerald Epstein: The main weakness of the Dodd-Frank Act is that it did not break up the "too big to fail" financial institutions. As a result, these large financial institutions retained the power to blackmail the public to bail them out the next time there is a financial meltdown and, as we have seen since Trump was elected, to buy off enough politicians to roll back the weak financial regulations that were passed. More generally, Dodd-Frank had way too many loopholes that resulted from financial sector lobbying so that it could never be implemented in its strongest form.

No, Dodd-Frank did not contribute to anemic growth. There is no evidence of this. Anemic growth was largely due to the legacy of the financial crisis itself, in which a great deal of household wealth was decimated, and to the continuing austerity policies that the Republicans were able to force on a weak-kneed and Wall Street-bedazzled Obama administration. On top of these factors are the long-term structural problems of the US economy related to the high level of inequality — itself largely due to the oversized power of Wall Street — and to the widespread disinvestment of US multinational corporations from the US economy, among other factors. If anything, Dodd-Frank worked against some of these tendencies, and thereby helped to sustain the long economic recovery that the Trump administration is now benefiting politically from.

The "Economic Growth, Regulatory Relief, and Consumer Protection Act" will allegedly be good for consumers and small businesses. Is there any truth to this claim?

No. Not really. But before answering in detail, it is important to realize that this Act was one of the only bipartisan bills that have been passed since Trump came into power. So, this is not entirely a Republican or a Trump initiative. A number of Democrats supported this bill, both in the House and in the Senate. And the same was true of the broadside that Wall Street leveled against tighter regulations in

the fight over Dodd-Frank in 2009-2010. The reach of Wall Street goes far beyond the Republicans. According to official data from the Americans for Financial Reform, Wall Street pumped almost $2 billion into the 2016 elections, and in 2017-2018, has already spent $719 million on lobbying and campaign contributions. Democrats get 40 percent of this money. At this level of spending, that is certainly not "spare change."

There have been a number of excellent analyses of the impact of the "The Economic Growth, Regulatory Relief, and Consumer Protection Act" by the Americans for Financial Reform, Demos, Better Markets and other organizations. These analyses show that the most likely effects of the law will be to allow financial institutions to more easily once again engage in "predatory lending" of the type that pushed excessively large and costly mortgages onto those who didn't want them and couldn't afford them; to more easily engage in redlining that discriminates against people of color in providing financial services; to more easily hoodwink investors by selling them risky financial investments; and to reduce the capital cushions on financial institutions so that it would make it more likely that these institutions would have to go hat-in-hand to the Federal Reserve and Treasury (i.e., the taxpayers) to get bailed out next time there is a financial crisis.

More generally, should it happen, what will be the most likely consequences of the repeal of the Dodd-Frank Act for the US economy?

We are more likely to see souped-up versions of the toxic, speculative activities that led to the great financial crisis; we are more likely to see the return to the short-term-oriented investment focus that has characterized US corporations who find it much more lucrative to engage in "get rich quick" financial returns, rather than longer term investments in the productive economy; we are likely to see the acceleration of corporate raiding of pension funds and other forms of workers' savings to line the pockets of financiers; and we are likely to see further finance-directed undermining of workers' standard of living, as pointed out by the excellent work of economists William Lazonick and Eileen Appelbaum and Rosemary Batt,who have researched the ways that speculative financial activities are undermining the long-term health of the American economy.

Economic models have not been good at predicting financial and economic crises, yet the prevailing sentiment among many progressive economists is that the next

financial crisis is just a matter of time. Do you share this view?

As the late, well-known economist Charles Kindleberger showed in his definitive history, "Manias, Panics and Crashes," financial crises are a "hardy perennial." He estimated they occur somewhere in the world about every seven years. So, as long as we have capitalism, we are going to have financial crises. The issue is how often and how severe and who will pay the price. If the financial industry and its allies in business and government continue to reap enormous short-term profits by shifting the risks to workers and communities, as they will be able to do more easily with the gutting of Dodd-Frank, then the chances of another major crisis go up considerably. And who knows how it will end this time around. With the venality and incompetence of the Trump administration, it is especially difficult to predict.

Given the predatory nature of neoliberal capitalism, what would an ideal regulatory financial regime look like?

The main principle is that the financial sector should serve society rather than the other way around. This usually means that we not only need strict financial regulation, but also a significant segment of public and non-profit financial institutions that are designed to serve society. I call this "finance without financiers." In order to make this, these institutions need to be large enough and/or a significant enough part of the economy to thrive and make an impact on the financial markets. This requires the financial authorities — especially the Federal Reserve — to support these institutions just as they have supported the massive private financial firms. This includes offering subsidized short-term credits and a safety net for them. Other important components include limiting the incomes private financiers make so that the socially–oriented financial staff are less tempted to act more like private, speculative bankers. Other regulations need to be in place but this will give an idea of what is required.

In the end, as long as we have a system of neoliberal capitalism, it will be difficult, politically and economically, to implement such a progressive and effective financial regime. But the struggle for a more equitable and sustainable economy must include financial programs like these.

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EU's Debt Deal Is "Kiss of Death" For Greece

After eight long and extremely painful years of austerity due to gigantic rescue packages that were accompanied by brutal neoliberal measures, in Athens, the "leftist" government of Alexis Tsipras has announced that the era of austerity is now over thanks to the conclusion of a debt agreement with European creditors.

In the early hours of June 22, a so-called "historic" deal on debt relief was reached at a meeting of Eurozone finance ministers after it was assessed that Greece had successfully completed its European Stability Mechanism program, and that there was no need for a follow-up program.

The idea that Greece's bailout programs can be considered a success adds a new twist to the government's Orwellian doublespeak, given the fact that the country has experienced the biggest economic crisis in postwar Europe, with its gross domestic product (GDP) having shrunk by about a quarter, and reporting the highest unemployment rate (currently standing at 20.1 percent) of all European Union (EU) states.

On top of that, the ratio of the country's public debt to gross GDP has risen from 127 percent in 2009 to about 180 percent, a development which has essentially turned Greece into a debt colony, leading to pressing demands that all valuable public assets be sold — including airports, railways, ports, sewerage systems, and gas and energy resources. Indeed, since the start of the bailout programs, Greek governments have been trying hard to outdo one another on the privatization front in order to satisfy the demands of the official creditors, the EU and the International Monetary Fund (IMF). Still, the current pseudo-leftist Syriza government has proven to be the most servile of Greek governments to creditors.

Arguments for privatization aside, the deadly combination of higher debt and declining GDP had most economists convinced quite early on that austerity was killing Greece's economy, and that a debt write-off would be at some point absolutely necessary for medium- and long-term recovery. However, Germany and its northern European allies had diametrically opposed this idea, insisting on even stronger doses of austerity, while balking at the prospect of a debt write-off.

At the same time, the idea of Greece exiting the euro was also an anathema to Germany and the eurocrats in Brussels. Keeping Greece in the Eurozone — even while its economy and society were going to bleed to death as a result of harsh austerity measures — was deemed absolutely imperative for the very survival of the euro, and for ensuring that all previous debts to European banks were going to be repaid. Indeed, it was these concerns that led to the bailouts in the first place — not the duty or obligation of helping out a member of the European family bounce back from a financial crisis that had been caused, to a large extent, by the highly flawed nature of the architectural design of the European Monetary Union itself.

The idea of restructuring Greece's huge debt pile, which kept on getting bigger with every passing year of austerity and neoliberal reforms, never went away, especially since the IMF never got tired of telling the Europeans that the country's debt level was unsustainable. Indeed, the IMF refused to join the third bailout until debt relief was put on the table.

Afraid of going alone with its neoliberal experiment and neocolonial attitudes toward Greece, European officials kept hinting on various occasions that a time may come when debt relief for Greece could become a topic of negotiations. However, it seems that the last elections in Germany may have been a turning

point in that direction, particularly with Wolfgang Schäuble having been forced to relinquish his role as Germany's finance minister for that of speaker of the Bundestag.

In contrast to Tsipras's outrageous claim that the debt deal represents a "historic" agreement, in that it allows Greece to become a "normal country" once again, the measures agreed on to make Greece's debt sustainable will doom the country into becoming a permanent semi-peripheral debt colony of the EU. The deal simply pushes the debt into the very distant future, and locks society into a state of perpetual austerity by requiring that the government run exceedingly large primary budget surpluses. The deal is not a cause of celebration for Greece but, rather, a kiss of death.

First, it grants Greece a 10-year extension on some pressing loan maturities and provides extra funds to the government in the sum of 15 billion euros in order to boost its cash reserves. In other words, no debt write-off of any kind, with the total amount of debt remaining around 180 percent, but simply making the next generation responsible for the repayment of a sizeable chunk of debt. This decision is supposed to enhance Greece's financial credibility and allow the country to return to private markets for its future borrowing needs.

The debt agreement also compels Greece to run primary budget surpluses of 3.5 percent until 2022, and then by about 2.2 percent until 2060. This means, then, that Greece will be in a state of severe austerity for the next 40 years. In fact, the demand that Greece runs a primary budget surplus of 3.5 percent until 2022 means that the doses of austerity will have to be increased substantially in the years ahead. This is especially the case since there is interest involved on the repayment of the loans, which means that the actual fiscal surplus is even bigger.

Indeed, when we take into account interest payments on debt, even at the rate of 1 percent until 2022, the overall fiscal surplus demanded from Greece as part of the so-called "historic" debt deal jumps to around 5.3 percent of the GDP through 2022. But even after 2020, the annual fiscal surplus demanded from 2023-2060 (assuming that the interest rate remains at 1 percent, although it will probably be higher) will be a minimum of 4 percent of GDP. (I am obliged to the economist Robert Pollin at the University of Massachusetts at Amherst for pointing out this important detail regarding the impact of interest rates on the actual primary budget surplus.)

At this point, with primary budget surpluses running in the range of 5.3 percent (until 2022) and even 4 percent (from 2023-2060), "severe" is not the right word to describe the level of austerity that will need to be enforced on the Greek population. A more apt term is "brutal" austerity, and such large primary surpluses inevitably bring to mind the condition of Germany at the end of World War I, when the country was forced to run similarly large surpluses in order to finance the reparations demanded by The Treaty of Versailles in 1919. Of course, what happened afterward is now common knowledge — except, apparently, among the German political class and the eurocrats in Brussels.

The debt deal for Greece is indeed a turning point: It marks the death of any prospect or hope for economic recovery and a return to normalcy. Only more difficult times lie ahead.

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