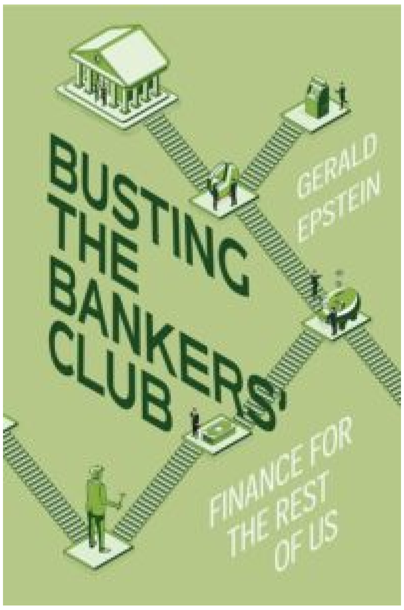
SEC’s Approval Of Bitcoin Markets May Set The Stage For Financial Disaster



01-10-2024 ~ *Irresponsible banking and deregulation are putting the world economy at risk.*

Over the past several decades, there have been rapid and fundamental changes in the finance and banking sectors. The banking reforms of the New Deal, which endured up until about 1980 and provided a relative degree of banking and financial stability, were reversed by the neoliberal counterrevolution with an eye toward increasing profits and shredding social responsibility. A new book by world-renowned progressive economist Gerald Epstein, *Busting the Bankers’ Club: Finance for the Rest of Us*, shows us the result: a financial system dominated by megabanks and shadow financial institutions prone to instability and crises that at the same time rely on government bailouts.

The neoliberal financial system, controlled by what Epstein calls “The Bankers’ Club,” benefits exclusively powerful people and institutions, is linked to the growing inequality of wealth and income, and is a net drain to the U.S. economy. Nonetheless, bankers not only see themselves as “essential workers,” a view that Epstein shreds into pieces, but as former Goldman Sachs Chief Executive Lloyd Blankfein claimed, many think they do “God’s work.”

The latest development in the evolution of the modern financial system is the Securities and Exchange Commission’s approval of bitcoin exchange-traded funds last month, concluding a decade-long fight and marking a turning point for cryptocurrency. This may be a game changer for the global money system but could also very well lead us to another financial crisis.

In this first of a three-part exclusive interview for *Truthout*, Epstein discusses the ascendence of financialization, the dangers of cryptocurrency and his pathbreaking book *Busting the Bankers' Club*. Epstein is professor of economics and co-director of the Political Economy Research Institute (PERI) at the University of Massachusetts Amherst.

C. J. Polychroniou: Financialization, a process by which financial markets and financial incentive increasingly become the predominant forces in domestic and international economies, dates back to the early 20th century but has intensified over the past five decades. Your new book, Busting the Bankers' Club, explores virtually all the major features and aspects of financialization, divulges the staying power of finance while exposing at the same time the failures of the current banking and financial system, and offers concrete pathways toward building a system of finance that works for the average people. Let's start by asking you to talk about your description of the financial system as having a Jekyll-Hyde personality. What is good and what is bad about the financial system?

Gerald Epstein: In the first chapter of *Busting the Bankers' Club* I refer back to the old Robert Louis Stevenson story, *Strange Case of Dr. Jekyll and Mr. Hyde.* In this tale Dr. Jekyll, an upstanding member of the community, also contains within himself a hidden other: the murderous criminal Mr. Hyde. Jekyll is sometimes tempted to turn himself into Hyde to indulge his perverse pleasures, but sometimes wants to resist the evil urges of the Hyde side of his personality in order to remain on the right side of society and the law. This is a good metaphor for finance. On the one hand, finance is a positive and even necessary force in our society: It facilitates the payment system so we can sell and buy things; it provides a safe place to hold and augment our savings; financial institutions can lend us money to enable us to buy important big-ticket items, like houses and educations, or to open businesses; and financial institutions provide us with insurance against accidents, health disasters and other life traumas. But the Hyde face of finance is always lurking in the background, driven by capitalist greed and excess. And if it is unchecked by laws and regulations (and, perhaps, moral fortitude), reckless and destructive finance can dominate our financial system, and at times, our economy. We saw the havoc that finance could create with the great financial crisis of 2008-2009. But such finance can also undermine our economy on a daily basis: overcharging for basic financial services like asset management and payments services; excluding some groups from financial services altogether; and perhaps most dangerously, engaging in high-risk speculative ventures that, if they crash, the top financiers will expect to get bailed out by the government.

Over the course of time, the world has witnessed virtually countless financial and banking crises, but there also have been periods with no such crises. For instance, you point out in your book that there was "a long period of financial tranquility" in the U.S. economy between World War II and 1980. What was different in the operations of the financial system during this period, and does the absence of financial and banking crises mean that the system had no failings and was in no need of reform?

In the U.S., the big banks and highly speculative financial institutions were widely perceived as having greatly contributed to, if not caused, the Great Depression of the 1930s. The Roosevelt administration implemented a set of New Deal financial regulations that greatly helped to stabilize the U.S. financial system for more than 30 years. Since the U.S. economy was the biggest economy in the world following WWII, these — along with the Bretton Woods Institutions created in 1944 and other factors — helped stabilize the global economy as well. The New Deal financial reforms focused on cutting the financial institutions down to manageable sizes (the Glass-Steagall Act separated investment from commercial banking); limiting bank runs by implanting deposit insurance; restricting speculation and predation by limiting leverage and what assets financial institutions could buy and sell (including limiting obscure products such as complex derivatives); and imposing social missions on various segments of finance — e.g. commercial banks would take deposits and make short-term loans to business, savings and loans would offer mortgages, investment banks would underwrite securities for businesses and state and local governments, etc.

The financial structure has often been called a system of "boring banking."

Of course, these regulations were not perfect. Far from it. The financial structure formally and informally embedded the highly discriminatory aspects of U.S. society. The financial system excluded people of color, especially Black Americans, from getting mortgages and other financial services; women were dependent on their husbands or fathers to obtain financial services; and the poor and working class were generally underserved by these financial institutions or charged exorbitant prices. Still, this New Deal financial structure was relatively stable and did provide credit for businesses and some households, and did facilitate the economic growth of the early post-World War II period.

The postwar financial regulatory regime, which had been created during the 1930s under the New Deal, begins to break down between the late 1960s and early 1970s. What caused the breakdown of the New Deal financial structure, and why do we end up with the full liberalization of the financial and banking system instead of improvements to the regulatory framework?

The breakdown of the post-WWII New Deal monetary regime was due to both domestic and global financial, economic and political factors. Worldwide, there was increasing globalization and the revival of major economic and financial competitors to U.S. dominance, including Japan and some countries in Europe. U.S. banks and financial institutions wanted to break out of the strictures of the New Deal regulatory regime, including limitations on asset portfolios and on interest rates they could pay on deposits, in order to compete with foreign rivals, especially with respect to providing business services for U.S. and other multinational corporations. Second was the increasing inflation caused first by increased U.S. spending on the Vietnam War and military buildup connected with the Cold War and then by the OPEC oil price increases in the 1970s. This inflation harmed U.S. banks, which could not sufficiently increase interest rates on deposits to compete with new unregulated financial institutions like money market funds created by asset managers like Fidelity. In the face of these structural problems, the New Deal system had to be reformed in order to provide more flexibility for the banks subject to their strictures. It is very likely that such reforms could have been implemented. But the big banks such as Citibank, Bank of America and Chase Manhattan Bank used these disruptions as an opportunity to gather together their allies, both inside and outside of government, to push regulators, the Federal Reserve and Congress to destroy the old New Deal System entirely. I call this group “The Bankers’ Club.”

You point out in the book that the changes that were brought about allowed the banks to create a new business model, which you label “roaring banking.” How does roaring banking work, and who are the primary beneficiaries of this new business model?

The current financial system is dominated by huge "universal" banks that combine deposit taking, lending, bond and derivatives trading, underwriting and even commodities trading. Banks like Citigroup, JPMorgan Chase, Bank of America, Goldman Sachs, etc. have virtually no financial boundaries and are so huge that if they get into serious trouble, they are too big to rescue, and their failures, like that of Lehman Brothers, might create a major panic. We saw these concerns in Spring of 2023 when even medium-sized banks were teetering. Their major business model is to use high levels of leverage to take risky bets on speculative assets of all kinds; and to use their quasi-monopoly power to intersperse themselves in order to capture business by municipalities, federal governments, companies, pension funds and households to take a slice of a huge percentage of financial transactions not only in the U.S. but also throughout much of the world.

But in addition to these behemoths are massive asset managers such as BlackRock and State Street. Then there are huge hedge funds, which "are alternative investments that use various methods such as leveraged derivatives, short-selling, and other speculative strategies to earn a return that outperforms the broader market," according to Investopedia. The biggest of these include Citadel, Bridgewater Associates and D.E. Shaw. Also key players in the world of "roaring banking" are increasingly powerful private equity firms, which, according to the brilliant work of Eileen Appelbaum and Rosemary Batt, employ enormous amounts of debt to take over important companies in retail, medical, real estate and nursing home industries, among others, as well as impose draconian work conditions on employees and saddle the companies with debt, so that the key owners of these private equity (PE) firms can extract maximum short-term profits. These PE firms include Blackstone; KKR, an infamous leveraged buyout company from the 1990s; and the Carlyle Group.

This nexus of financial behemoths has very little regulation and is able to extract enormous wealth from customers and employees. With favorable tax treatment and bailouts from government, it is able to garner such enormous wealth that they help generate the most unequal income and wealth distribution the U.S. has had since 1929.

Bailouts have become the norm under the deregulatory financial and banking regime. Who should get bailed out and why?

Government bailouts are one of the main forces that keeps this system of roaring banking going. The Dodd-Frank Financial Reform Act passed in 2010 and signed into law by President Obama was touted by the administration as ending "too big to fail" and bailouts. But in fact, the bailout problem has remained and possibly gotten worse. As we saw from the near-global financial market meltdown in March of 2020 when the World Health Organization declared the COVID pandemic, the Federal Reserve and the U.S. Treasury (as well as other major central banks) poured trillions of dollars into the financial markets to stabilize them, and even took measures to bail out some hedge funds and other non-bank institutions. And when Silicon Valley Bank went bankrupt and several other medium-sized banks trembled in the spring of 2023, again the Federal Reserve intervened to virtually guarantee the entire U.S. system of bank deposits. By doing this, a major run on the financial system was avoided, but the episode pointed to enormous regulatory problems still facing our financial system.

There are three major problems with these kinds of bailouts. One is that they eliminate the incentives for the financiers to stop taking excessive risks because these risks pay off for them, if not for the rest of us. Second, they keep the same elites in power, undermining chances for more democratic control of our economy. And third, people understand that these bailouts are unfair and undemocratic. It makes them angry and helps them fall prey to demagogues such as Donald Trump.

Should there ever be bailouts? And if so, of whom? Good question. The late economic historian Charles Kindleberger surveyed hundreds of years of capitalist financial markets and pointed out that lender of last resort actions, i.e. bailouts, were endemic and frequent. I tell my students: Even if we sometimes need to bailout the banks, we do not need to bailout the bankers. I think this is the important point. Sometimes we need to maintain the viability of institutions that by their nature are subject to risks. But we do not want to reward the bad behavior of those who will exploit them and us to keep their lofty status in the class hierarchy.

During the COVID pandemic, we heard a lot about essential workers. Are bankers essential workers?

Well, many of the top bankers think they are. Lloyd Blankfein, former chief executive of Goldman Sachs, famously said after Goldman helped crash the economy in 2009 and received massive government bailouts that, "We're very important. We help companies to grow by helping them to raise capital.… This, in turn, allows people to have jobs that create more growth and more wealth. It's a virtuous cycle." In fact, he told *The Times* of London that as a banker, he is doing "God's work."

But as my former graduate student Juan Antonio Montecino and I show in *Busting the Bankers' Club*, "roaring banking" is a net drain on the U.S. economy, compared to what a modern system of boring banking would be. Far from being essential workers, these mega bankers, hedge fund operators and private equity executives are reducing the rate of economic growth and extracting wealth from the majority of people in the economy.

The Securities and Exchange Commission (SEC) recently gave a stamp of approval to bitcoin exchanged-traded funds. How significant is this development?

This approval could be quite significant, especially if it sets legal and/or regulatory precedents that lubricate the downward slope of integrating crypto assets into that traditional financial architecture. In some ways, this event gives me a "déjà vu all over again" feeling, reminding me of some of the early decisions on deregulating derivatives and credit default swaps in incremental ways in the run-up to the Great Financial Crisis. A number of these dangers were highlighted in a detailed and passionate dissent to the decision written by SEC Commissioner Caroline A. Crenshaw. The core of Crenshaw's critique is that these bitcoin exchange-traded funds are based on bitcoin assets, which themselves are largely unregulated and traded on dark platforms in many parts of the world. There is little transparency as to what determines the prices of bitcoins and there is a lot of evidence that they are manipulated and subject to fraudulent practices, often without recourse. This provides many opportunities for illegal activity such as money laundering as well as arms and drug financing and trade. The basic critique is that, like with predatory subprime mortgages and problematic asset-backed securities, you can dress them up with fancy packaging and complicated bells and whistles, but the underlying garbage still stinks. Crenshaw knows how precedents get set in the regulatory business. And just as derivatives and other complex securities were slowly but surely allowed to be sold in the run-up to the financial crisis by incremental nose-under-the-tent procedures (*"Well, this new thing is just like the old thing that you already approved"*) Crenshaw and other critics, such as those at Americans for Financial Reform and Better Markets, are rightly worried that once again we are headed down a slippery slope. Crenshaw rightly asks: "When FTX [Sam Bankman-Fried's company] imploded … many of us breathed a sigh of relief that the downfall of one of the most central players in the crypto market had little impact on global markets more broadly. Will approval of today's products provide the previously attenuated nexus to traditional markets [that is, break down the previous barriers] that allows crises in largely non-compliant crypto markets to spill over? These questions are not considered in today's Order."

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C.J. Polychroniou is a political scientist/political economist, author, and journalist who has taught and worked in numerous universities and research centers in Europe and the United States. Currently, his main research interests are in U.S. politics and the political economy of the United States, European economic integration, globalization, climate change and environmental economics, and the deconstruction of neoliberalism's politico-economic project. He is a regular contributor to *Truthout* as well as a member of *Truthout's* Public Intellectual Project. He has published scores of books and over 1,000 articles which have appeared in a variety of journals, magazines, newspapers and popular news websites. Many of his publications have been translated into a multitude of different languages, including Arabic, Chinese, Croatian, Dutch, French, German, Greek, Italian, Japanese, Portuguese, Russian, Spanish and Turkish. His latest books are *Optimism Over Despair*: *Noam Chomsky On Capitalism, Empire, and Social Change* (2017); *Climate Crisis and the Global Green New Deal*: *The Political Economy of Saving the Planet* (with Noam Chomsky and Robert Pollin as primary authors, 2020); *The Precipice*: *Neoliberalism, the Pandemic, and the Urgent Need for Radical Change* (an anthology of interviews with Noam Chomsky, 2021); and *Economics and the Left*: *Interviews with Progressive Economists* (2021).