Getting to the root of the financial crisis: the new blame game

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Financial crises of the scale of the one currently underway are great educators. The people they hurt come quickly to discover things about circuits of finance capital of which, in better times, they had been entirely ignorant. We all know now things about commercial paper, overnight lending and mortgage-backed securities that we didn't know before. But sadly, for most of us, this knowledge has come too little and too late.

The search for culprits is underway, and rightly so; but who we blame predetermines where we look for a solution. So is it a question of the bad management of financial institutions, or of their mismanagement, or their lax management, or does the ultimate source of our current difficulties lie elsewhere and deeper still?

If the culprit is the Bush Administration and the heavy-fisted Henry Paulson, then this crisis can be explained away, as some commentators have done, as the product of bad management. If the main culprits are Fanny Mae and Freddy Mac, then what is in play is the mismanagement of the entire housing sector. If responsibility lies further back, with the governing philosophies at the Fed, then we are living with the consequences of Alan Greenspan and financial deregulation: we are living in the shadow of lax management. But if the problem lies deeper still, in the poverty of those unable to pay the mortgages they committed themselves to, then what we are experiencing in the banking system is but one manifestation of a deeper and more structural malaise.

This financial crisis is like a layered cake. Each layer is part of the problem

> ** This crisis has been allowed to fester ever since the sub-prime loan difficulties began to emerge in 2007: Henry Paulson has done too little, too late.*
> ** The sub-prime loan process was visible before it created problems; Fanny Mae and Freddy Mac, among others, could have stopped it, and they didn't. They actively encouraged the practice, under pressure from both the Clinton and Bush administrations.*
> ** The easing of regulations of the entire financial system during the Greenspan years did open the way to speculative banking based on mortgage-backed securities: a tougher regulatory framework could and should have prevented that.*

But there is a deeper issue here, one not yet being widely recognized or discussed.

Twice since the war the US has known prolonged periods of economic growth: from 1948-73 and again from 1992 (with a brief dip in 2002) to now.

** In the first of those economic booms, the internal deal underpinning growth was a union-negotiated productivity-wages pact – rising productivity and rising wages went together in a social contract that gave the long post-war boom a strong internal base.*
** The second time round the internal deal was different. It was one imposed by an over-confident business class on a seriously weakened labor movement, one combining rising productivity with rising income inequality.*

For the vast majority of working Americans, wages stagnated during this second boom – rising only briefly in the late 1990s before stagnating again. Since 1992 growth has rested on a Faustian contract between Main Street and Wall Street. Wall Street has been awash with money, and keen to lend. Main Street, by contrast, has been financially pressed, and was keen to borrow. The second post-war boom rested not on rising wages but on credit, on money borrowed from Wall Street by US consumers, and borrowed by Wall Street in significant measure from financial sources abroad. Houses built on sand invariably in the end fall over.

The immediate credit crisis clearly requires a regulatory fix of some kind. But equally clearly, the long-term weakness of the US economy requires a resetting of the underlying social contract. Currently we are debt soaked. We have never been so debt soaked; and we will have periodic credit crises until we dry out. We need to return to a world in which rising productivity and rising wages go together, so that people buy commodities today out of wages they earn today, not out of wages they might earn tomorrow and which they bring forward only by borrowing at high rates of interest. The underlying requirement now is one of reconfiguring investment in the United States so that good jobs return to America, and of reconfiguring the tax code so that good wages return to the middle class. We need a new deal as well as a new Treasury Secretary.

Does anyone in Washington realize that? I hope so, but I rather doubt it.