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Article Title: The Political Economy of the Subprime Crisis: The Economics, Politics and Ethics of Response

Year of publication: 2010
Link to published version:
http://dx.doi.org/ 10.1080/13563460903553533
Publisher statement: 'This is an electronic version of an article published in Brassett, J. et al. (2010). The Political Economy of the Subprime Crisis: The Economics, Politics and Ethics of Response. New Political Economy, Vol 15(1), pp. 1-7. The New Political Economy is available online at:
http://www.informaworld.com/smpp/content~content=a920495786~db=all~jumptype=rss

The Political Economy of the Subprime Crisis: The economics, politics, and ethics of response

James Brassett, Lena Rethel and Matthew Watson

Media and policy discourses on the subprime crisis and the ensuing credit crunch have been dominated by historical analogies, whereby a sense of how bad things have been since the autumn of 2007 arises from comparing the situation directly to other notable moments of financial meltdown. Typical of this approach is the measured insistence of the Chair of the US Federal Reserve, Ben Bernanke, that the spiral of illiquidity which engulfed the banking sector in September 2008 provided the most serious threat of systematic bank collapses since the Great Depression. Such constructions are clearly not without justification. Commercial banks have been nationalised at a rate unprecedented in recent memory; the once seemingly omnipresent giant US investment banks have failed to survive in their extant form; the UK has witnessed its first genuine run-on-the-bank dynamics since the middle of the nineteenth century; the interest rate spread between inter-bank lending and government bonds has reached record highs almost worldwide; and the drying up of mortgage lending has led to record annual falls in house prices in many countries. However, as an explanatory device, inference by historical analogy alone places unnecessary and unhelpful restrictions on attempts to understand how events surrounding the sub-prime crisis and its associated credit crunch have unfolded.

Linking the present to the past in this way suggests that the current crisis is merely a moment of instability, puncturing an otherwise stable financial environment with a temporary mishap occasioned by an equally temporary misallocation of bank resources. From such a perspective, all that might be necessary for the status quo ante to be revived is decisive intervention designed to rid current conditions of their anomalies through increased emphasis on transparency and accountability. Perhaps predictably in such circumstances, the mantra of good governance to counter conflicted interests in the banking sector has been dusted down and given new life as a catch-all antidote to ostensible historical abnormalities in finance. The rhetoric of "seriously delinquent" finance emerging from within the IMF (Dodd 2007) has underpinned calls for enhanced levels of bank self-restraint; the UK Chancellor Alistair Darling's reflections on the social irresponsibility of some bankers' "kamikaze manner" do likewise (Darling 2009). Such appeals invite the possibility of a future exclusion whereby rogue lenders are forced out of the market in order to revive the functioning financial system which will be left behind once they have been expelled.

Here, though, the proffered solution to the crisis pre-empts genuine analysis of its causes by enforcing the characterisation of their manifestations as abnormalities. What if instead the problem from which the subprime crisis arose is actually the very essence of modern banking sector 'normality' (Brassett, Rethel and Watson 2009: 378)? On this view the sub-prime crisis is not a moment of instability in an otherwise well-ordered political settlement for finance, so much as a signal event highlighting deeper changes and probable contradictions related to the ongoing financialisation of global capitalism.[1] The unparalleled expansion of individual credit and debt in recent years has led to concerted efforts on the part of banks to commodify the financial aspirations of everyday investors by innovating in risk management techniques related

to asset securitisation. The sheer normality of highly leveraged trading in these assets points to an urgent systemic question; the sheer normality of catering for people's financial security through embedding their accumulated wealth in speculative asset price movements points to another. In this way, we believe that the subprime crisis can be usefully (re-)read as the fulcrum of wider social and moral shifts in the nature of debt, risk and expectations regarding responsible financial behaviour. The question of responding to the sub-prime crisis therefore moves beyond technical fixes to improve the allocative efficiency of the banking sector and is bound up with deeper political and ethical commitments to how finance should be organised and in whose interest that organisation should take place.

An important issue for scholars seeking to develop such a theme is where they might turn for literature to assist them in that task. As is perhaps to be expected of events that crystallised in their most dramatic form only eighteen months ago, the academic literature is still somewhat sparse. Some modern classics on general conditions of financial uncertainty have been either reprinted in their original form in order to allow today's readers to draw their own implications about the sub-prime crisis (e.g., Minsky 2008 [1986]) or reprinted with brief additional chapters devoted to the crisis (e.g., Krugman 2008 [1999]). To a significant extent it is still just too soon for an autonomous specialist academic literature to have evolved and to have settled into consistent patterns of scholarship. It should hopefully go without saying that it is one of the primary objectives of this special issue to begin to map out how those patterns might be established in the future.

This is not to suggest, though, that there has been no academic input thus far into media and policy discourses surrounding the sub-prime crisis. Many publishers spotted an important opportunity very early on in the unfolding of the crisis to commission academics and other opinion-formers with public profiles to comment on events as close as possible to their origins (e.g., Shiller 2008; Soros 2008). The audience to whom these books are designed to appeal is not, however, an academic audience. Therefore there is a tendency for their analyses to concentrate on the surface relationships underpinning falling house prices and stalling credit markets rather than on the broader capitalist restructuring which has made the manifestation of these surface relationships largely unremarkable. They are almost always silent on the process through which credit expansion, the commodification of future welfare needs and the purposeful creation of bubble dynamics are all somewhat predictable outcomes of an increasingly financialised model of capitalism. The focus on why house prices have fallen and why credit markets have stalled might well recognise some of these features but hardly ever attributes them to the normal workings of contemporary finance. Our contributors were asked to think specifically about such connections as a means of transcending explanations based on purely surface relationships.

Another literature whose major themes will not be replicated in our contributors' work is that written by journalists specialising on the mortgage lending market and on the activities of modern investment banking corporations. The former have pinpointed with great skill the decisive moments in which seemingly sustainable business models linked to an unusually buoyant housing market spilled over into wilful lending excesses (e.g., Muolo and Padilla 2008; Mason 2009). The resulting analysis often morphs into popular psychological studies of key industry insiders' motivations for

riding the house price bubble for all it was worth. The second prominent journalistic contribution has been to produce similarly-styled accounts of how investment banks reorganised their internal operations to create additional space for their activities in the mortgage securitisation market (e.g., Cohan 2009; McDonald and Robinson 2009). Once more, personalities come to the fore in the explanation of how the market was made and how its reproduction was undermined by the increasingly reckless positions being taken within it.

What follows now is a collection of eight original research-based articles which depart from so much of the existing writing on the sub-prime crisis in their conscious prioritisation of distinctly academic approaches to the subject matter. Each piece stands alone on its own merits and we do not wish to falsely impute a consistent narrative of response which was no part of our contributors' intentions. However, it is possible to order the articles into three loose groupings. The first focuses more on the international level, while the second highlights the implications of conceptualising adequate responses for a politics of the everyday. The third relates the sub-prime crisis to wider social dynamics of financial markets and the broader restructuring of an increasingly financialised capitalism.

Turning initially to the first grouping, the articles by Jacqueline Best and Grahame Thompson view the current crisis in comparative perspective in order to understand what lessons global policy elites have applied when attempting to ameliorate the symptoms of financial market distress during the credit crunch. For Best, the question is how responses to the current crisis have failed – and quite conspicuously so – to learn from the Asian financial crisis of the late 1990s amid protracted and ultimately unsatisfactory debates over a New Financial Architecture. Contingent ambiguities in financial knowledge and practice are the very stuff of repeated financial crises, and reading history forwards from the meltdown of Asian markets to today shows that such ambiguities have never been mastered via ever more complex risk management techniques that emerge from within markets themselves. The very fact that we have a sub-prime crisis to write about indicates that the packaging and re-packaging of risk perpetuates more risk. This is because the definition of what within the financial sector counts as risk in the first place has itself become an aspect of market self-regulation and therefore is distorted by the outbreaks of the bubble dynamics which are a constant feature of financialised capitalism. Like many of our contributors Best shies away from advocating purely technical responses to be pursued within the context of continued market self-regulation, on precisely the grounds that it was such techniques which produced the current situation. Instead, she advocates a multi-faceted response when viewed internationally, one in which different national economic value systems produce different policy outcomes when released from the homogenising influence of globally-imposed norms.

Thompson's primary conclusion largely concurs with Best's. He interrogates the widespread understanding that the circumstances in evidence since the autumn of 2007 constitute a distinctly 'global' crisis. He argues that quite apart from there being a global financial system, what we in fact see is a set of nationally demarcated systems and that the global spread of the Anglo-American debt credit crunch is in fact merely a classic case of contagion with symptoms jumping from one system to the next. Thompson gives short shrift to the suggestion that the international economy exhibits seamless integration of national financial markets, demonstrating his point

through analysing the structural disjuncture between different spatial scales of finance which is caused by the continuing presence of different national currencies. On this basis he supports the idea that the regulatory response should be founded on the principle of 'distributed preparedness for resilience' instead of another set of top-down rules issued by the institutions of global economic governance in the name of a New Financial Architecture. This is the functional equivalent of Best's multi-faceted response, because it entails each country constructing its resilience in its own way, depending on the precise features of the national economic system.

The final piece of the first grouping is written by Duncan Wigan. Along with the subsequent articles by Paul Langley and Timothy Sinclair, the broad theme of response is dealt with most stridently here. Each of these articles chimes with a stance of critical questioning along the lines: 'Response? What response?' In this sense they seek to explore the issue of power in global finance and the way it operates through private and discursive channels to consolidate certain conceptions of 'normal' finance. Wigan provides a cutting account of the way in which successive cycles of crisis and re-regulation have entrenched globally the power of finance in general and the role of derivatives in particular. He argues that the focus of crisis analysis should shift from the dominant narrative of pathology contained in the comparison of bubble and post-bubble asset price dynamics to the question of power. In Wigan's account the policy prescriptions of crisis abatement strategies – in particular the now fabled bank bail-out packages – have served predominantly to reproduce the circumstances that have created finance as we now know it and which render the contradictions of a financialised capitalism an increasingly normal characteristic of everyday life. He treats this as the most obvious symptom of the state's impotence when it comes to the control of financial innovation. Private actors, he argues, now define the parameters of feasible public responses to moments of financial market meltdown; the prospects of escaping these privately-imposed norms are distant indeed.

The articles by Paul Langley and Leonard Seabrooke form the second grouping. They tackle more directly the salience of finance for the politics of 'everyday life' and its effective instantiation in responses to the subprime crisis. Langley provides a technically sophisticated and authoritative treatment of performativity and what it implies for the analysis of financial markets. His underlying point is that the dominant media and policy discourses linking the crisis to a sudden outbreak of illiquidity pre-empted anything more concerted than a really rather superficial examination of alternative responses. If illiquidity promotes market meltdowns, so the reasoning ran, the only possible source of ameliorating continuing market distress is to make markets liquid again. It is interesting to note in passing that the small print of the bank bail-out packages introduced around the world from the autumn of 2008 has all cited this as the priority of policy. Langley shows that this particular technical diagnosis of the troubles that befell financial markets simultaneously performs its own intended solution: to make markets liquid again on the presumption that liquid markets are functioning markets and that functioning markets represent their socially optimal form. He suggests that the question of whether securitisation techniques have an ethically and politically legitimate place in the provision of mortgage finance was never seriously considered. Instead, the emphasis of the bail-outs was governed by the fetishising of liquidity and, as a consequence, the sole concern was how to re-start securitisation as quickly as possible.

In his contribution, Seabrooke also discusses the range of possible decisions that could be made around the issue of re-starting securitisation, although he focuses explicitly on the question of how to re-start it whereas Langley's piece pushes readers to consider rather more whether it should be re-started. Seabrooke's discussion is situated analytically at the nexus of the relationship between individual life chances and welfare trade-offs that underpin phenomena like sub-prime lending. He outlines how mass expectations concerning access to credit in the US – as well as in other similarly-positioned Anglophone economies – place hard constraints on the policy space for regulatory reform and that the demands arising from the political system come close to ruling out the option of not re-starting mortgage securitisation. However, the everyday politics of getting access to credit raises not only issues of creditworthiness but, in the US at least, issues of race and discrimination. Seabrooke concludes that the ongoing efforts to use part of the bail-out money to restart securitisation must account for the social structures embedded within everyday politics. As a result, he raises the possibility that a radical regulatory overhaul of the US mortgage regime are most unlikely, because the racialised dimension of credit creation is a limiting factor on the social and political breadth of financial norms.

The third grouping of articles relates the subprime crisis to broader social dynamics of financial markets in the manner prefigured in Seabrooke's analysis. The power-centred approach which is a dominant feature of the pieces by Wigan and Langley also shines through the piece by Sinclair. He analyses the 'othering' practices of media and policy discourses that work to identify perpetrators in the crisis. Focusing on the bond rating agencies he identifies an interesting politics in the discourse of 'moral panic' that works to discipline particular instances of financial innovation while paradoxically sidelining critical claims about the inherent problems of global finance. These othering practices consequently play a normalising role which squeezes the space for discussing how the power manifested in global finance draws attention away from its generic contradictions when issues of regulation come to the fore. From Sinclair's perspective there is doubtless plenty of critical noise in commentaries on the sub-prime crisis, but it invariably works to produce scapegoats at the same time as diminishing opportunities to question the morality of particular social structures of debt and to suggest alternative practices of finance. In this case the distribution of power lying behind the surface relationships of reputations for creditworthiness remains crucially unexplored.

The argument of Julie Froud and her co-authors complements the arguments in the previous two pieces. They offer a powerful critique of the justifications advanced by policy-making elites concerning the allegedly benign effects of financialisation and the opportunities that financialisation offers for the creation of new cadres of asset-holders. Even though their article follows neither Seabrooke's nor Sinclair's in engaging explicitly with responses to the current crisis, it does provide salutary lessons on much of the back-story to their analyses. It shows how the intrusion of ethical discourses of finance via issues of 'financial democracy' and the 'ownership society' can silence potential agents of political mobilisation against today's normal finance far more effectively than they help to energise such struggles. Many recent attempts have been made to ameliorate the pathologies of unequal earned income via the creation of credit lines for low-income families in the interests of homeownership, pension provision and savings. Froud et al argue that such 'social innovations' actually serve to further entrench the inequalities that their proponents claim they

solve. They suggest that one possible resolution to the current crisis might emerge from a new class alignment whose political form relegates the emphasis on rising asset prices below traditional social democratic concerns like income distribution and social protection.

Finally, the article by Ismail Ertürk et al provides an exciting response to the ongoing difficulties encountered within media and policy discourses of providing an adequate specification of the core characteristics of hedge funds. Hedge funds have recently come under increased scrutiny because they have been so much a part of the 'blame game' surrounding the sub-prime crisis – similarly to Sinclair's sense of 'perpetrators' – but they remain largely mysterious and therefore often escape serious analytical study. Ertürk et al elaborate a conceptual deconstruction of the prevalent images of hedge funds as either trader/arbitrageurs or speculator/gamblers. For them the appropriate metaphor is 'war machine', one which offers a more dynamic vision of how they act not only as traders but also as conscious manipulators of the 'battlefield' on which trading strategies emerge. Hedge funds' activities are dominated not by any transcendent approach to how to operate within the market environment, but by a series of short-term interventions designed to do whatever it takes in order to reconstitute the core features of the market to their own advantage. Deception, threat and tactical alliance are all shown to be part of hedge funds' strategic repertoire if this is what is required to 'make their positions work' and therefore to maximise the returns on their investments. Such war machines exist in specific conjunctures and adapt and respond to the challenges of the prevailing battlefield – in this instance the rapid withdrawal of liquidity associated with the sub-prime crisis. The consciously conjunctural analysis provided by Ertürk et al tells us much about the conditions of normal finance out of which the current crisis arose.

Notes

[1] This was the alternative proposition that the participants were asked to consider at the two-day workshop out of which this special issue was put together. The workshop was held at the University of Warwick on 18/19 September 2008. We gratefully acknowledge financial assistance from the host institution, the Economic and Social Research Council (project number RES-000-22-2198), GARNET – the EU Network of Excellence on Global Governance, Regionalisation and Regulation and the Political Studies Association of the UK. More information about the workshop appears at http://www2.warwick.ac.uk/fac/soc/pais/research/ipe/subprime/, including links to the recordings of all the academic papers.

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