Neoliberalism, the Great Recession, and the Winners and Losers in the Largest Redistribution of Wealth in History

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Socializing Loses & Privatizing Profits
Largest Redistribution of Wealth in History
Corporate Welfare & Bailout

"Yeah, yeah, this is just temporary... the free market works best when there's no government intervention... get in line, buddy!"
The Theory of Theory

“It is theory that determines what can be observed.”
Albert Einstein

The Theory of “it”:
“It is what it does.”

The Theory of positions:
“You stand where you sit.”
Unemployment by Income Distribution
4th Quarter 2009 (official figure 10.2 %)

Unemployment Rates in the U.S. for Workers in Selected Deciles of the Household Income Distribution, 4th Quarter 2009 (in %)

<table>
<thead>
<tr>
<th>Household Income Decile</th>
<th>Percent</th>
</tr>
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<tbody>
<tr>
<td>Lowest</td>
<td>30.8</td>
</tr>
<tr>
<td>Second</td>
<td>19.1</td>
</tr>
<tr>
<td>Fourth</td>
<td>12.2</td>
</tr>
<tr>
<td>Sixth</td>
<td>7.8</td>
</tr>
<tr>
<td>Eighth</td>
<td>5.0</td>
</tr>
<tr>
<td>Ninth</td>
<td>4.0</td>
</tr>
<tr>
<td>Top</td>
<td>3.2</td>
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</tbody>
</table>
Depressions & Redistribution: Theory & Practice

“In a depression, assets return to their rightful owners.”

- Andrew Mellon (Financier & Secretary of Treasury)

The 2008-09 bailout “the largest redistributions of wealth in such a short period of time in history.”

Joseph Stiglitz, Nobel Prize winner in Economics; Chief Economist, World Bank 1997-99; Chief, Council of Economic Advisors
State-sponsored redistribution of wealth 2008-09:

- Global losses in the banking sector were $3.6 trillion.
  
  *IMF, October 2009*

- U.S. tax-payers’ bailouts and guarantees $12 trillion

- (Total exposure $23 trillion - Special Inspector General for TARP report to the Congress).

- U.S. GDP $14 trillion

- 9 lenders with a combined loss of $100 billion, received $175 billion in bailout money, paid out $33 billion in bonuses, with $1 million apiece for nearly 5000 employees.
# Other Big-Ticket Items v. 2008-09 Bailout of Finance Capital

<table>
<thead>
<tr>
<th>Big Budget Expenditure</th>
<th>Cost</th>
<th>Inflation Adjusted Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marshall Plan</td>
<td>$12.7 billion</td>
<td>$115.3 billion</td>
</tr>
<tr>
<td>Louisiana Purchase</td>
<td>$15 million</td>
<td>$217 billion</td>
</tr>
<tr>
<td>Race to the Moon</td>
<td>$36.4 billion</td>
<td>$237 billion</td>
</tr>
<tr>
<td>S&amp;L Crisis</td>
<td>$153 billion</td>
<td>$256 billion</td>
</tr>
<tr>
<td>Korean War</td>
<td>$54 billion</td>
<td>$454 billion</td>
</tr>
<tr>
<td>The New Deal</td>
<td>$32 billion (est.)</td>
<td>$500 billion (est.)</td>
</tr>
<tr>
<td>Gulf War II/Invasion of Iraq</td>
<td>$551 billion</td>
<td>$597 billion</td>
</tr>
<tr>
<td>Vietnam War</td>
<td>$111 billion</td>
<td>$698 billion</td>
</tr>
<tr>
<td>NASA</td>
<td>$416.7 billion</td>
<td>$851.2 billion</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$3.92 trillion</strong></td>
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</table>
12 trillion $ bailout
[exposure 23 trillion]
Water water everywhere – not a drop to drink!

- World output USD 48.6 trillion,
- Market capitalization USD 48.6 trillion,
- Banking assets USD 29 trillion,
- Bonds USD 67.9 trillion,
- Foreign exchange markets USD 3.1 trillion daily
- Derivatives USD 596 trillion
- 90 percent of international financial flows represent speculative and hedging behavior
- Two fifth of humanity without access to a bank account - much less credit
How did we get here?

❖ History –
  • cycles of boom and bust until 1929

❖ Theory-
  • Free Market v. Accumulation by dispossession

❖ Policy –
  • Laissez-faire v. New Deal
Accumulation by Dispossession – From Precondition to Ontological Condition of Capitalism

The market always needs the extra-market legal and extra-legal enablers

- “Laissez-faire was planned; planning was not.”
  Karl Polanyi, The Great Transformation 145 (2001 [1944])
- “The market has been the outcome of a conscious and often violent intervention on the part of government which imposed the market organization on society for non-economic ends.”
  Karl Polanyi, The Great Transformation 258 (2001 [1944]).
- “Probably nothing has done so much harm to the market advocates’ cause as the wooden insistence ... on certain rules of thumb, above all the principle of laissez-faire capitalism.”
  Friedrich Hayek, Constitution of Liberty 502 03(1960)
- “The hidden hand of the market will never work without a hidden fist.”
  Thomas Friedman, The Lexus & the Olive Tree 373 (1999)
Chronic Crises of Capitalism

- Tendency of the rate of profit to fall

- Overproduction – lack of aggregate demand

- Financial Crises:
  - hedge financing, to risky speculative financing, to unsustainable Ponzi financing
  - “Minski moment”-
  - Boom and bust cycle
  - The Problem of “hot-money”
Figure 1-1: Bank Suspensions and Failures Per Year, 1864–Present

* Actual values for 1930–33 are 1,352, 2,294, 1,466, and 4,004.
Finance Capital & Theorists of the Ages

Banks and the Virginia Gentleman Farmer

“Banking institutions are more dangerous than standing armies.”

Thomas Jefferson

The Bond Market and the “ragin’ cajun”

“I used to think if there was reincarnation, I wanted to come back as the president or the pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody.”

SAVING CAPITALISM FROM ITSELF

The Post-Depression Social Compact – Keynesian Consensus/compromise:

- Macroeconomic interventions to increase aggregate demand.
- Restrictions on capital, particularly regulation of finance capital.
- Full employment, high wages, high productivity.
- Labor rights.
- Welfare and Developmental Systems.
- Opening for expanded civil, social, and economic rights.
- No major crisis for 25 years – the “Golden Age.”
- Financial crises have occurred at roughly ten-year intervals for the last 300 years. The only exception was the quarter century between 1945 to 1971.
Post World War II International Financial Order – Phase I.

- “New Deal in international economics ... driving the usurious money lenders out of the temple of international finance.”
  
  Henry Morgenthau, 1944

- Bretton Woods 1944 / Keynesian International Finance:
  
  * Cross- Border Capital Controls – containing “hot-capital”

  * National autonomy in fixing interest rates

  * Indirect gold standard - Dollar as anchor of global economy

  * Dollar convertible at $35 per oz.

  * The “Golden Age” age of capitalism (1945-71) made possible.
Signs of Economic and Political Trouble

Falling Rates of Profit & Income of the top 1% declining.

Stagnation and decline of rates of growth

Military-Industrial Complex and Imperial (Over)Reach –

Butter + Guns find Vietnam.

The Tipping Point

1968 – “the year that changed the world”:
Tet offensive, Chicago, Paris, Prague, Mexico City, and a few other places
Top .01% Income Share - 1913-2003

Can you identify a tipping-point when you see one?
Share of Income of the top 10%
The Emerging Dollar Crisis:

- Outflow of dollars - Emergence of “offshore finance” – the unregulated Eurodollars and Eurobonds.
- Eurodollar market is born – finance capital breaks its chains
First Attempts to Solve the Problem:

- **Unilateral default** to repay debts in the form contracted for.

**New Problem:**

- Will others finance our growing deficits [fiscal and balance of payments]
- Will they accept IOUs (Treasury bills) as the new coin of the imperial realm?
- How do you win the confidence of the Bond Market??????

**Neoliberal Counter-revolution is born:**
The Solution –(for finance capital ?):

- Resurrect the dollar
- Attack inflation – the enemy of finance capital v. Unemployment – the enemy of the working classes.
- Abandon the domestic and international Keynesian consensus /compromise
- Rollback working class gains – “wage flexibility” (union busting)
- Road test
  - Pinochet’s Chile/ The “Chicago Boys” and tight monetary policy
  - New York 1975 / “Drop dead” and take the unions with you.
- Financial Services Revolution + Americanization of Int’l Finance necessary component
SHOCK THERAPY
– the economic counter-revolution

*Reconstruction of empire begins at home.*

❖ **The Volcker Shock** (1979-82)

- **Induced recession** to check inflationary spiral and bargaining power of labor.

- Fed base rate rose from 8% in 1978 to 19% in 1981.

- 1981-82 worst recession since the Great Depression – output dropped by 2.2% in 1982 and unemployment reached 9.7%. Inflation dropped from 13.5% in 1980 to 3.2 in 1983.

- Confidence of the financial markets through **radical use of monetary policy**.

- Inflow of capital - US Treasury bills now “coin of the (global) realm.”

- Massive secondary markets in bonds – we are off to the races.

- “*The triumph of central banking.*” Paul Volcker
Reagan-Thatcher political counter-revolution:

- Rollback workers’ rights – “Kill the Unions”
  - 35% in 1945; 27% in 1970; 23% in 1980
  - 12.4 in 2009 [36.8 % public; 7.6 % private sector]

  “Government is the problem.” *Starve the beast* – tax cuts and more tax cuts.

- Union busting moves:
  - Overseas production and purchase of foreign-produced inputs.
  - Wage freezes and wage cuts after 1980. In 1982, 44 % of unionized workers bargaining for new contracts took wage cuts or a wage freeze.
  - Elimination of COLA clauses in labor contracts.
  - Two-tier wage structure – auto and Postal service.
  - Full time workers replaced by “temps.”
  - “Union avoidance.” – plant closing, bankruptcy.
  - Elimination of PATCO (Professional Air Traffic Controllers Organization) 1981.
  - Chrysler bailout and UAW get a “hair-cut” (1981).
Ideological/ Political War of Pacification:

“There is no such thing as society. There are only individual men and women, and there are families.”

Margaret Thatcher, 3 Oct., 1987

Except, of course, “ownership society.”

❖ Fracture working class solidarities – union-busting.

❖ Turn class-war into culture-war/ politics of backlash

   – From “war on poverty” to war on the poor.

   – Displace Civil Rights and Women’s Rights with Family Values.

   – New Poster Childs: “the welfare-queen,” “the illegal alien,” and “the homosexual.”

❖ Restructure political forces


   – Alignment of religious right, and segregationists-lite with Wall Street.
Mythologies of the Chicago School

- **Efficient Market Hypothesis**
  - Market always tends towards equilibrium
  - Supply and demand always evens out
  - The price is always right
  - There is no information differentials
  - Unemployment is voluntary leisure
  - Markets self-regulate and self-correct

- *Homo Economicus:*
  - “the economic approach provides a useful framework for understanding all human behavior.” Gary Becker 1976

- **Policy Implications:**
  - Supply side
  - Trickle down

Law and Economics anyone????
Neoliberalism Goes Global

- The Washington Consensus, shock therapy, and disaster capitalism

- Global governance without global government: The IMF / Treasury /TWO Complex:
  - Good-Cop/ Bad-Cop duo / World Bank & IMF
  - Surveillance and conditionalities
  - Fiscal and monetary policy “discipline”
  - Privatization, Liberalization
  - Rollback the state
  - Liberalization of trade and exchange rates.
  - Liberalize financial markets.
  - Flexible labor markets – flexibility of wages not immigration

- Bad Samaritans – Myth of free trade and the history of capitalism
Financial Revolution - “Innovations” in financial products and services:

- CDs, money market funds, credit cards, 401-k, and securitization of commercial banking. “And BTW – may we use your pension funds?”

- Transformed role of banks: from “storage business” to “moving business.”


- From “boring banking” to “shadow banking.” structures investment vehicles

- Americanization of global finance.

Financial crises are inevitable, but now the US can act as “*chief of the fire department.*”

*Robert Rubin*
De/Regulation through Re/Regulation- hidden hand of the market and iron fist of the state:

- **Depository Institutions Deregulation and Monetary Control Act 1980**
  mandated a complete phase-out of interest-rate ceiling by 1986. (Volker Shock facilitator).

- **Addition of the 401K provision to the tax code in 1980**
  channeled incomes into private pension plans

- **Garn-St. Germain Depository Institutions Act of 1982**
  lifted restrictions on the savings and loan industry to enter commercial lending and corporate bonds, and allowed inter-state mergers between banks and S&Ls

- **Secondary Mortgage Market Enhancement Act of 1984**
  permitted investment banks to buy, pool, and resell mortgages in slices with varying levels of risk

- **Tax Reform Act of 1986**
  created the Real Estate Mortgage Investment Conduit, making mortgage-backed securities more attractive

- **Financial Institutions Reform, Recovery, and Enhancement Act of 1989**
  rearranged the government-sponsored entity landscape
De/Regulation through Re/Regulation- cont’d

- **Reigal-Neal Interstate Banking and Branching Efficiency Act 1994**
  3-year phase-in elimination of branching restrictions. [Repeals McFadden Act 1927- proscribed interstate bank branching to ensure availability of credit to small-scale local productive capital.]

- **Personal Responsibility and Work Opportunity Act 1996**
  [Welfare “reform”]

- **Gramm-Leach-Bliley Financial Services Modernization Act 1999**
  [Repeals Glass-Steagall Act 1933 – separation of commercial banking and investment banking; separation of financial and non-financial firms.]

- **Commodities Futures Modernization Act 2000**
  [No regulation of derivatives]

- **The Bankruptcy Abuse Prevention and Consumer Protection Act 2005**
  made consumer bankruptcy difficult
“Sound practices” for unsound activities?


- Include deals that “lack economic or business purpose,” and are “designed or used primarily for questionable accounting, regulatory or tax objectives, particularly when the transactions are executed at year end or at the end of a reporting period.”

- “As a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit.” George Stigler, *The Theory of Economic Regulation*, 1971.
Neoliberalism in America – “debtor nation”/“sharecropper society”:

- **Creation of Aggregate Demand:** Full Employment v. Debt
  - US *debt-to-GDP ratio* from 110 percent (1970) to 293 percent (2007)
  - From 2000 to 2008, real median *household income* decreased by 4%.
  - Number of *hours worked* per household has gone up 26% over the last 30 years.
  - CEO –to-worker *pay imbalance*: 1965 = 24 -1; 1982 = 42-1; 1989 = 71-1; 2005 = 431-1
  - Financial capital in the US, 15% of total capital in 1979; 25% in 2005.
  - In 2007, the financial markets absorbed 41% of corporate sector profits.
  - On average homeowners paying 40 to 50% of their income to banks.
Fruits of the neoliberal counter-revolution in the U.S.

- Share of wealth of top 1% went from 9 to 24%
- 58% of income growth went to the top 1%
- Share of financial industry assets held by top 10 conglomerates went from 10% to 60%
- Finance as the main source of wealth for the Forbes 400 went from 9% to 27%
Household dept as percentage of GDP
Figure 3-1: Real Corporate Profits, Financial vs. Nonfinancial Sectors

Financial Profits as Percentage of Total Profits

Chart 1. Total Financial Profits as Percentage of Total Domestic Profits

Source: Bureau of Economic Analysis, *National Income and Product Accounts*, Tables 1.1.4, 6.3, 6.5; calculation by the authors. Banking includes financial sector less insurance, real estate, and holding companies. Annual compensation is total wage and salary accruals divided by full-time equivalent employees.
Primary Sources of Forbes 400 Wealth

Chart 2. Primary Sources of Forbes 400 Wealth
(Percentages, Selected Years)

*Retail in 1982 is included in Other.

CEOs’ pay as a multiple of workers’ pay

CEOs' pay as a multiple of the average worker's pay, 1960-2007
Share of Capital Income by Top 1%
Inequality Rising

Inequality rising: Inflation-adjusted household incomes, 1970-2005

Share of Wealth by Bottom 99%
Unfunded Pension Obligations
Hegemony of Finance Capital: Moral Hazard is for mere mortals

Heads I Win, Tails You Lose!

- Moral hazard, financial innovations, and public bailout.
- The “Greenspan /Bernanke put.” & “Too big to Fall.”
- Corporate welfare and corporate safety net.
- Naked Credit Default Swaps – or how to buy insurance on your enemy’s house

  The Bankruptcy Abuse Prevention and Consumer Protection Act 2005

- If you complain, “you” are waging class warfare – ask Rubin and Summers.
Credit Default Swap - Algebra Anyone?

\[(1 - p_1) N(1-R) \delta_1 + p_1 (1 - p_2) \left[ N(1-R) \delta_2 - \frac{Nc}{4} \delta_1 \right] + p_1 p_2 (1 - p_3) \left[ N(1-R) \delta_3 - \frac{Nc}{4} (\delta_1 + \delta_2) \right] + p_1 p_2 p_3 (1 - p_4) \left[ N(1-R) \delta_4 - \frac{Nc}{4} (\delta_1 + \delta_2 + \delta_3) \right] + p_1 p_2 p_3 p_4 \left( \delta_1 + \delta_2 + \delta_3 + \delta_4 \right) \frac{Nc}{4} \]

Myron Scholes and Robert Merton - Long Term Capital Management
Financial Industry’s Machinations – *Facilitated by laws and regulations:*

- Securitization distracted banks from their core function.
- Modern *alchemists* turned risky sub-prime mortgages into AAA-rated products.
- Bankers acted greedily because they had *incentives and opportunities* to do so.
- Financial markets *failed in their essential functions of managing risk.*
- Innovations directed at *circumventing regulations*, accounting standards, and taxation.
- Complexity of products increased risk and *informational asymmetries.*
- *Regulators’ R’us*, and Congressmen are on an “inspection tour” of Virgin Islands
Financial weapons of mass destruction: 
*It is not complexity, it is legal and extra-legal frameworks*

- By 2002, big investment banks had leverage as high as 29-1.

- With SEC’s April 2004 decision, even more leeway was given and some increased their leverage to 40-1.

- Credit default swaps – naked credit default swaps (buy or sell insurance without owning any debt of the reference entity).

- No trading on an exchange and no reporting requirements.

- CDS “invented” in 1997 by JP Morgan to sell credit risk of Exxon to European Bank of Reconstruction and development.

- $ 47 trillion by the end of 2007.

- *Commodities Futures Modernization Act* 2000 made derivative including CDS exempt from regulation.
The Ticking Bomb:

- Total outstanding derivatives = $592 trillion.

- Total bailout liability = $23.7 trillion.
  Office of the Special Inspector General for TARP, Quarterly Report to Congress, July 2009

- U.S. GDP = $13 trillion
Double standards – finance capital is more equal than others (even other capital):

- A clear double standard: contracts for AIG executives were sacrosanct, wage contracts for workers in firms that received help had to be renegotiated.

- Moral hazard and the “Greenspan put.” Too big to fail & bailouts.

- For GM and Chrysler, the standard rules of capitalism applied: upon bankruptcy, shareholders lost everything, while bondholders and other claimants (union health funds and taxpayers) became new shareholders.

- Conservatorship tarnished as “nationalization.” Obama suggests this wasn’t the American way. Bailing outs financiers and speculators is?

- Socialism with American characteristics /Capitalism American Style .

- Privatize profits / socialize losses.

“Capitalism without bankruptcy is like Christianity without Hell.”

The New Yorker, May 18, 2009
Wall Street – Washington revolving door.
Wall Street /Washington - Regulatory Capture.

Larry Summer’s self-proclaimed greatest achievement as Secretary of Treasury in 1999-2001: “ensuring that derivatives would remain unregulated.”

Banks “the most powerful lobby in Capitol Hill. And they frankly own the place.”
• Senetor Richard Durban, April 2009

Can journalists be far behind?
Conflict of interest exemption for Paulson – Sept. 17, 2008
Finance Capital and Obama Administration- more of the same

<table>
<thead>
<tr>
<th>Name</th>
<th>Selected Finance-Related Positions</th>
<th>Connections to Financial Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timothy F. Geithner</td>
<td>Secretary of the Treasury</td>
<td>President and Chief Executive Officer, New York Federal Reserve Bank/Chairman of Morgan Stanley</td>
</tr>
<tr>
<td>Neal S. Wolin</td>
<td>Deputy Secretary of the Treasury</td>
<td>1982-1985 Under Secretary of the Treasury, 1983-1985 33rd Secretary of the Treasury</td>
</tr>
<tr>
<td>Jack L. Lew</td>
<td>Chief of Staff to Treasury Secretary</td>
<td>2009-2010 Under Secretary of the Treasury, 2009-2011 Director of the National Economic Council</td>
</tr>
<tr>
<td>Jeffrey A. Zients</td>
<td>Under Secretary for Economic Growth and Director of the National Economic Council</td>
<td>2014-2015 Acting Director of the National Economic Council</td>
</tr>
<tr>
<td>Jacob J. Lewin, Jr.</td>
<td>Assistant Secretary to the President of the United States</td>
<td>1993-1994 Assistant Director of the National Economic Council</td>
</tr>
<tr>
<td>Michael E. Froman</td>
<td>Assistant to the President of the United States</td>
<td>2005-2011 Deputy Assistant to the President of the United States</td>
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<td>Mary S. Alexander</td>
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<td>Ken N. White</td>
<td>Assistant Secretary for Legislative Affairs</td>
<td>2004-2009 Assistant Secretary for Legislative Affairs</td>
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<tr>
<td>Gary Genscher</td>
<td>Counsel to the Secretary of the Treasury</td>
<td>2001-2005 Counsel to the Secretary of the Treasury</td>
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<tr>
<td>Matthew R. Paull</td>
<td>Deputy Assistant Secretary of the Treasury</td>
<td>2009-2011 Deputy Assistant Secretary of the Treasury</td>
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<td>John Snow</td>
<td>Chairman of the Treasury of the United States</td>
<td>2005-2009 Chairman of the Treasury of the United States</td>
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<td>Lawrence H. Summers</td>
<td>Director of the Treasury of the United States</td>
<td>1993-2001 Director of the Treasury of the United States</td>
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<td>John Farley</td>
<td>Deputy Administrator of the Treasury of the United States</td>
<td>2007-2011 Deputy Administrator of the Treasury of the United States</td>
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<td>David Lipton</td>
<td>Deputy Administrator of the Treasury of the United States</td>
<td>2007-2011 Deputy Administrator of the Treasury of the United States</td>
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<td>Other Key Officials</td>
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<td>2005-2011 Deputy Assistant Secretary of the Treasury of the United States</td>
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<td>Neal Wolin</td>
<td>Deputy Director, National Economic Council</td>
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<td>Robert G. Zoellick</td>
<td>Deputy Secretary of the Treasury of the United States</td>
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<td>Richard L. Karp</td>
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Table 1: Financial Capital and the Obama Administration

Source: Various public sources including the Treasury Department and Wall Street Journal.
The Real Problem:

- Deficit of global aggregate demand.
- Gap between global demand and global supply.
- Some consuming more than they produce, others producing more than they consume.
- Fed blames global access liquidity/too much saving for inability to keep interest rates in the realm of reason.
- It is not access liquidity, stupid; it is insufficient aggregate demand.

2.7 billion survive on less than two dollars a day.

The Roadblocks:

- Lack of transparency:
  - FED claimed that Freedom of Information Act did not extend to it.
  - Loretta Presca, District Court Judge in NY ruled against FED, the FED appealed. August 24, 2009.

- Lack of political accountability and democratic control.
  - Monetary policy involves trade-offs between inflation and employment.
  - Bondholders worry about inflation, workers about employment.
What is to be done:
Towards A New Keynesian Compromise – national & global

- Bury the “Efficient Market Hypothesis” – efficiently!
- New Economic Policy
  - Public support of employment and distribution programs
  - Education, health, green economy, infrastructure
  - Redesign financial sector as a support sector
- Contain size of financial sector and actors – both global and national
- Global development and stabilization fund under U.N. supervision – IMF has got to go!

“Without global standards on capital and liquidity, Wall Street will set one jurisdiction against the other in a game of regulatory arbitrage.”
  - Business Week, April 19, 2010.
The Choice: Oligarchy or Democracy?

- Sharecropping and “IMF riots”

or

- A new social compact – social justice trumps private profits
“IMF Riot”

Pensioners assail the latest austerity measures Wednesday by rioting outside the premier’s office in Athens.
The $9 billion check

Because it was a holiday in Japan, rather than wire the money, Mitsubishi UFJ presented Morgan Stanley with a $9 billion check for its investment in the firm.