

**Capitalism,
Government,
Money,
and the
Future of
the World**

*Finding
and Keeping
the Right Balance
in
Market-Capitalist
Democracies*

March **Bear Stearns** collapses; government arranges sale to JP Morgan at a fire-sale price

July Subprime lender **IndyMac** fails, is taken over by the FDIC

Sun September 7 **Fannie Mae** and **Freddie Mac** are placed in conservatorship by the Fed

Mon September 15 Bank of America acquires **Merrill Lynch**, after Merrill loses \$50 billion on mortgage securities, and its solvency is in question

Lehman Brothers, having teetered for days, collapses in the largest bankruptcy in American history: \$680 billion. **The rapid systemic collapse of the financial sector, and the economy, begins**

Tues September 16 The Fed intervenes to prevent **AIG** from declaring bankruptcy, with an immediate injection of \$85 billion

Sat September 20 **Morgan Stanley** and **Goldman Sachs** contact the FRBNY, to warn of likely bank runs and collapse on Monday. The Fed issues them bank licenses and extends credit to stabilize them, as lender of last resort

Thu September 25 **Washington Mutual** fails, is taken over by the FDIC

Mon September 29 **\$700 billion TARP bailout bill is voted down in the House of Representatives**
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Fri January 16 **Bank of America** receives a \$20 billion loan, plus \$118 billion in guarantees

The maturation of monetary functions in the United States

to stabilize capitalism

ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE, LENDER OF LAST RESORT	FULL CENTRAL BANK OPERATIONS BEGIN	FED ASSERTS INDEPENDENCE TO SET INTEREST RATES	CRISIS-TESTED ABILITY TO SET INTEREST RATES INDEPENDENTLY	CRISIS-TESTED ABILITY TO INTERVENE MASSIVELY AGAINST INSTABILITY
1860s	1913	1934	1934-35	1951	1979 – 1980s	2008
Civil War need to raise huge amounts of money to prosecute war	Panic of 1907 need to be able to react strongly to stabilize during banking panics	Great Depression need to end bank runs and enforce banking stability	Great Depression need to end severe deflation	Korean War inflation need to end subordination to Treasury	1970s inflation need to definitively kill inflation expectations	Financial Crisis need to intervene massively to avert systemic collapse of the economy
Elimination of private bank notes Currency issued on gold standard	Federal Reserve established as new entity distinct from Treasury, with technocratic governance. But a significant part of the political establishment disagrees with the need for such an institution, and with the idea that govt should ever intervene in the economy	Deposit insurance established after banking industry is devastated by runs and panics. Fed begins to act as lender of last resort to banks, with much closer bank supervision and regulation	Convertibility to gold is ended, effectively ending gold standard. Everyone required to sell their monetary gold to the government. Dollar devalued from \$20.67 to \$35 to stop deflation	Until 1951, interest rates held artificially low to help limit servicing costs on massive WW2 national debt. But outbreak of heavy inflation causes need for Fed to start setting interest rates so as to actively stabilize currency value	Due to too-loose monetary policy and oil shocks, inflation surges and begins to self-perpetuate. Paul Volcker leads effort to crush inflation expectations. Very costly to economy in short run (bad recession), with heavy political criticism, but Fed succeeds in killing inflation	Vastly destructive panic breaks out in financial system, with economy on verge of a collapse at least on the scale of the Great Depression. Fed and Treasury successfully respond in force, with Congress' backing, but there is outrage and heavy political fallout in aftermath

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Of the 14 largest financial institutions in the US economy as of the beginning of 2008, 2 were able to survive without government intervention:

**JPMorgan Chase
Wells Fargo**

Had the other 12 biggest institutions all been allowed to fail, the American economy would have been totally devastated with almost unimaginable consequences, and with an ensuing depression that could easily have rivaled the 1930s

These unprecedented government interventions were led by a Republican presidential administration, despite **the intense opposition of most of President Bush's own party in the House of Representatives**

The effort succeeded only because large majorities of the Democrats in Congress supported the interventions

The collective interventions by the Federal Reserve, the FDIC and the US Treasury in 2008 constituted a rescue of capitalism from itself, on a staggering scale – but they instantly triggered **an outraged reaction against government**

On economic ignorance and political perversity

Alan Blinder, Vice Chairman of the Federal Reserve, 1994-1996



There was no Great Depression 2.0. The worst was avoided.

Realistic estimates are that real GDP by 2011 was on the order of \$1.8 *trillion* higher than it would have been, had there been no government interventions in 2008 and 2009, had we let the economy collapse into unrestrained freefall, like we did in the 1930s.

With that much more output, there were around *10 million more jobs* than there would have been, and the unemployment rate was around *6.5% lower* than it would have been. These are *huge positive effects*, that transformed what might have been utter catastrophe into something that was merely awful.

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*Generally speaking, you don't get credit from the public for taking actions that avert a catastrophe, because it's impossible to prove that a catastrophe **would have occurred, but for your action***

der of
no
conomy

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You might have thought that such a performance would restore faith in government and put the advocates of laissez-faire to rout.

But no.

Instead, in a perverse twist, there was a *backlash against government*.

Perhaps the counterfactual notion that *things would have been much worse* but for the extensive government interventions is too subtle for politics, too subtle for the average person's understanding of economics.

On economic ignorance and political perversity

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After all, policy levers were pulled all over Washington, and the economy tanked anyway. Must be government's fault!

By the same reasoning, the Fire Department causes fires.

Americans have long been ideologically conservative, but pragmatically liberal.

At the level of lip service, most of us have an inner Thomas Jefferson who makes us wary of big government.

On economic ignorance and political perversity

Alan Blinder, Vice Chairman of the Federal Reserve, 1994-1996



We don't trust either politicians, or concentrated power
– which are good ideas.

We prize both free enterprise and rugged individualism
– more good ideas.

We tend to resent government intrusion into our lives,
and we don't much like paying taxes.

All of these attitudes are quintessentially American.

On economic ignorance and political perversity

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But when push comes to shove, Americans sometimes must turn to government to solve real problems – whether it be settling the West, building canals and later highways, fighting wars, ending the Great Depression, providing essential social safety nets, and so on.

We idolize Jefferson, but we follow Alexander Hamilton.

On economic ignorance and political perversity

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This disjuncture between talk and action was captured perfectly in 2009, during the heated debate over health care reform, when an irate constituent in South Carolina angrily warned his congressman:

“Keep your government hands off my Medicare!”

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With regard to these government interventions themselves, when the final bill came in, what did all this cost the US taxpayer?

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Outcomes of the US government financial interventions of 2008-2009

Bear Stearns commitment	\$2 billion profit
Fannie / Freddie conservatorship	\$88 billion profit
AIG commitments	\$23 billion profit
Treasury mortgage security purchases	\$25 billion profit
TARP bank investments	\$24 billion profit
TARP credit market programs	\$3 billion profit
TARP housing programs	\$16 billion loss
TARP auto programs	\$15 billion loss
Fed general liquidity programs	\$20 billion profit
FDIC programs	\$13 billion profit
Money market fund guarantee	\$1 billion profit
State and local HFA initiative	\$2 billion loss
<hr/>	
Net return to FDIC and US Treasury	\$166 billion profit

FDIC, OMB, CBO, US Treasury and Federal Reserve Board figures as of 2013.

Tim Geithner, *'Stress Test: Reflections on Financial Crises'*, 2014

On the key takeaways of the crisis of 2008
Tim Geithner, President, FRBNY 2003-2009
US Treasury Secretary 2009-2013



This is the central paradox of financial crises:

What *feels* just and fair is often the opposite of what's required for a just and fair outcome.

It's why policymakers often tend to make crises worse, and why the politics of crisis management are always untenable.

The instinctive reaction to an epic financial crisis, of both the policy wonk as well as the politician, is to *punish the perpetrators* and *impose losses on their creditors*, while limiting taxpayer exposure to catastrophic risk.

On the key takeaways of the crisis of 2008
Tim Geithner, President, FRBNY 2003-2009
US Treasury Secretary 2009-2013



And on the fiscal side, it seems just as obvious to many, that at a time when families and businesses have to tighten their belts, government should tighten its belt, too.

All that sounds right. *But in a severe crisis, it's wrong.*

In a brutal financial crisis like 2008, actions that seem reasonable – letting banks fail, forcing their creditors to absorb losses, balancing government budgets – *only make the crisis worse.*

And the actions that *are necessary* to ease the crisis seem inexplicable and unfair.

On the origins of the panic of 2008
Martin Wolf

The financial system is inherently **fragile**.

It is prone to error and, of course, to fraud.

The financial system is also vulnerable to **panics** and **crises**.

This fragility is **integral** to the system and **generated by it**,
in periods of both **boom** and **bust**.

And, the view that **stabilized inflation** is a sufficient condition
for **economic stability** has been proved grotesquely wrong.

The truth is the opposite. A time of macroeconomic stability
is precisely when the financial system is likely to become *more fragile*,
because that is when people feel safe in taking on more risk.

And the view that market forces would make the financial system *stable*
was also proved egregiously wrong.

On the origins of the panic of 2008
Martin Wolf

**In fact, market forces do the exact opposite:
they *inevitably* generate euphoria and panics.**

**Success always breeds excess,
and excess inevitably breeds eventual crisis and collapse.**

The ignorance and the arrogance of the business community,
economists, academics, and government policymakers,
contributed greatly to making the Western financial system
more fragile.

The crisis became so severe in part because
so many people thought it impossible.

On price stability and economic stability

Shirakawa Masaaki, Governor of the Bank of Japan 2008-13

2013 speech



I don't mean to say that price stability itself creates problems or bubbles,
but a subtle link between the two does exist.

A prolonged period of high growth coupled with low inflation
gives rise to optimistic sentiment, which is at least partly responsible
for fostering bubbles.

On price stability and economic stability

Shirakawa Masaaki, Governor of the Bank of Japan 2008-13

2013 speech



We have to start by recognising this odd reality of bubbles being accompanied by price stability, yet then followed by instability of the financial system.

We have to admit that central banks that have accommodated asset price bubbles failed to achieve economic stability, given that both financial and price stability are essential elements of economic stability.

On price stability and economic stability

Shirakawa Masaaki, Governor of the Bank of Japan 2008-13

2013 speech



We have to think deeply about how best to relate the price stability mandate to financial stability when the central bank conducts monetary policy.

In this regard, the pre-Great-Recession orthodoxy was that price stability leads to financial stability and thus there is no inherent conflict.

However, this position is no longer tenable.

What this new intellectual climate exactly implies in terms of optimal policy has to be clarified further.



If a central bank does a really good job, over an extended period,
of maintaining stable prices / a stable currency value
(steady, low inflation)

while also keeping interest rates reasonably low

the reward will be
an extended period of steady, stable economic growth
– a sustained good economy, with expanding prosperity –
followed at some point by a huge new crisis

**Confidence in the economy, confidence in the future
is what powers a healthy economy**

The financial industry is always an essential enabler,
centrally involved in lending money and allocating capital to support growth

**But as confidence builds, over the course of a sustained period of growth,
at some indefinable point it starts to shade into overconfidence,
and the embrace of too much risk –
and that overconfidence may well set the stage for the next crisis**

The financial industry is always an essential vector,
centrally involved in enabling and precipitating every financial crisis

The maturation of monetary functions in the United States

to stabilize capitalism

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Today, most Americans are barely aware of government's critical ongoing role as the guarantor of bank stability.

Nor do they have the slightest awareness of how deposit insurance and the Fed prevent bank runs and banking panics, on an ongoing basis

Most Americans are also oblivious to how the US dollar works, and how the Fed actively manages its value.

And a prominent lunatic fringe thinks the Fed is a scam, and that going back to using gold as money would be better

And - Americans continue to be hazy at best, in their awareness of the instability of capitalism, and the need for government to intervene in a crisis of capitalism. A significant part of the population is frozen in 1930, thinking such intervention is by definition illegitimate

The maturation of monetary functions in the United States

to stabilize capitalism

ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY 1860s	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY 1913	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE, LENDER OF LAST RESORT 1934	FULL CENTRAL BANK OPERATIONS BEGIN	FED ASSERTS INDEPENDENCE TO SET INTEREST RATES	CRISIS-TESTED ABILITY TO SET INTEREST RATES INDEPENDENTLY	CRISIS-TESTED ABILITY TO INTERVENE MASSIVELY AGAINST INSTABILITY 2008
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In the longer-term aftermath, there is a growing awareness among all central banks, that their responsibility must be not just for *price stability*, but also for the *financial stability* of the macroeconomy – and that price stability *does not* ensure macroeconomic stability

From country to country, the political mandate that each central bank has, to proactively deal with financial instability, varies

The American Federal Reserve faces recurrent challenges to its insulation from politics. These challenges tend to become more acute during and after major crises

Today, most Americans are barely aware of government's critical ongoing role as the guarantor of bank stability.

Nor do they have the slightest awareness of how deposit insurance and the Fed prevent bank runs and banking panics, on an ongoing basis

Americans are to be hazy at best, in their understanding of the nature of capitalism, and the need for government to intervene to avert systemic collapse. This is a dangerous part of the American political tradition. It is frozen in time, and thinking such as this is by definition illegitimate

Central banks as the custodians of currency value – and of macroeconomic stability

Board of Governors of the Federal Reserve System

The Federal Reserve, the central bank of the United States, provides the nation with a safe, flexible, and stable monetary and financial system.

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Federal Reserve issues FOMC statement

Press Release - 11/3/2021

Federal Reserve Board issues statement in support of the Glasgow Declaration by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS)

Press Release - 11/3/2021

Federal Reserve Board invites public comment on a technical notice of review regarding primary dealers operating in Spain

Press Release - 10/27/2021

Federal Reserve Board announces it will host a series of diversity and inclusion conferences in November

Press Release - 10/25/2021

Speech by Governor Bowman on the lack of new bank formations being a significant issue for the banking industry

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WORK RELATED TO ECONOMIC DISPARITIES

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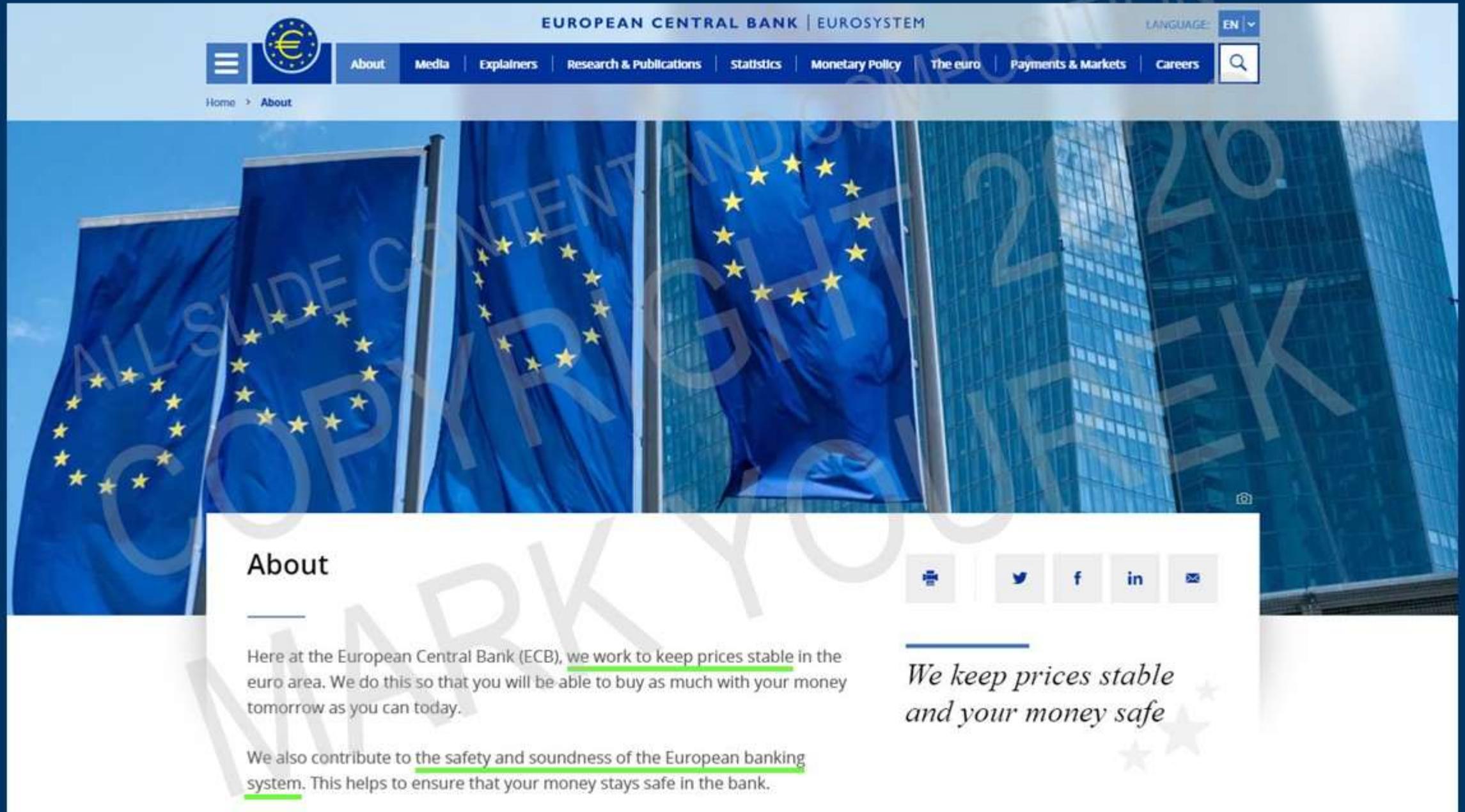
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Central banks as the custodians of currency value – and of macroeconomic stability



EUROPEAN CENTRAL BANK | EUROSISTEM

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About

Here at the European Central Bank (ECB), we work to keep prices stable in the euro area. We do this so that you will be able to buy as much with your money tomorrow as you can today.

We also contribute to the safety and soundness of the European banking system. This helps to ensure that your money stays safe in the bank.

*We keep prices stable
and your money safe*

Central banks as the custodians of currency value – and of macroeconomic stability

The Bank of Japan is the central bank of Japan.

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Outline of the Bank

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The Bank of Japan is the central bank of Japan. It is a juridical person established based on the Bank of Japan Act (hereafter the Act), and is not a government agency or a private corporation.

Objectives

The Act sets the Bank's objectives "to issue banknotes and to carry out currency and monetary control" and "to ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of stability of the financial system."

The Act also stipulates the Bank's principle of currency and monetary control as follows: "currency and monetary control by the Bank of Japan shall be aimed at achieving price stability, thereby contributing to the sound development of the national economy."

Central banks as the custodians of currency value – and of macroeconomic stability



The Bank of England

Promoting the good of the people of the United Kingdom by maintaining monetary and financial stability.

Search the Bank of England



0.1%

Current Bank Rate

£895bn

Quantitative Easing

3.1%

Current inflation rate

Bank Rate m
Monetary Policy

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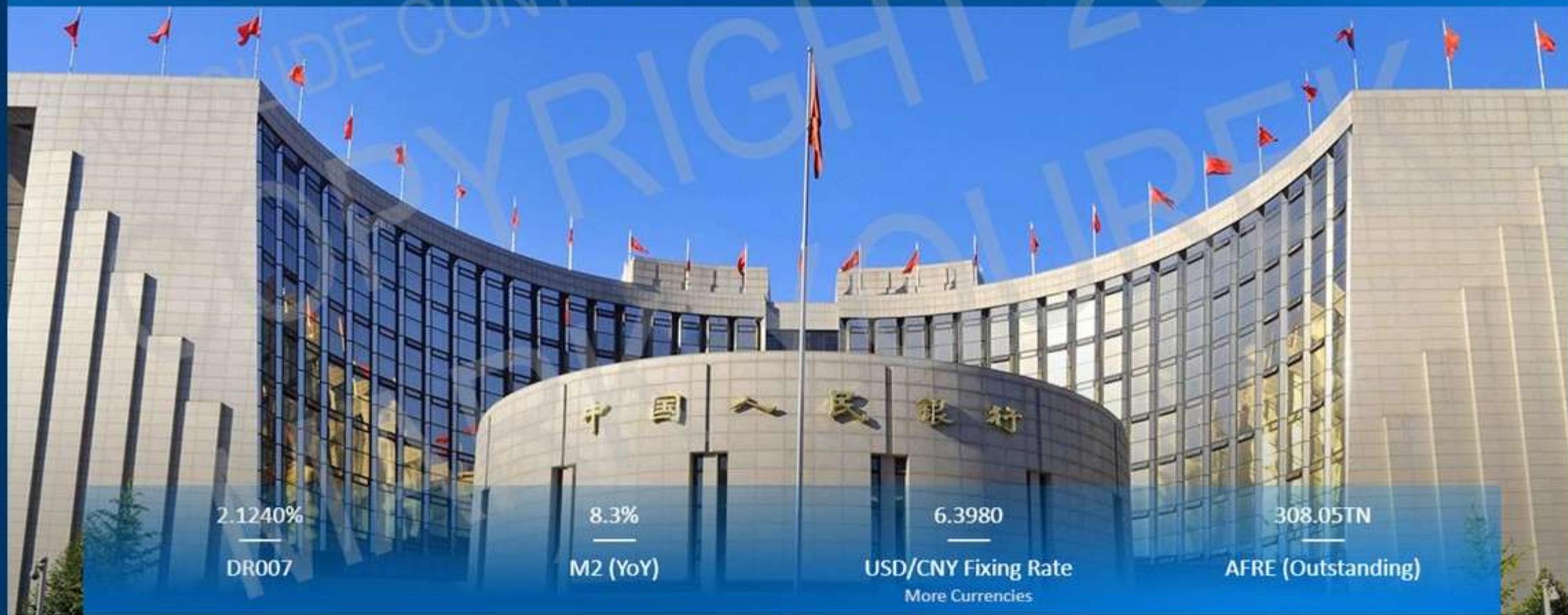


中国人民银行

THE PEOPLE'S BANK OF CHINA

The Central Bank of the People's Republic of China

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2.1240%

DR007

8.3%

M2 (YoY)

6.3980

USD/CNY Fixing Rate

More Currencies

308.05TN

AFRE (Outstanding)

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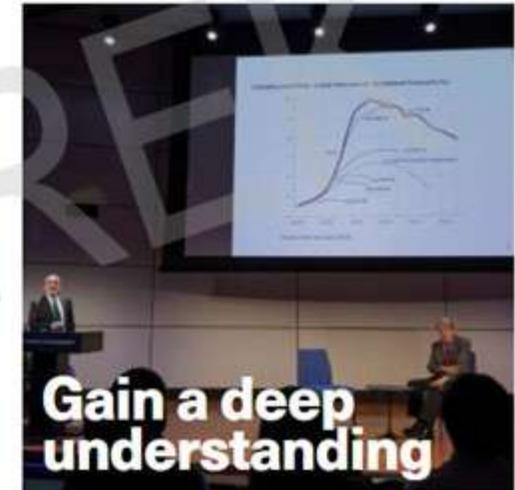
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Central banks as the custodians of currency value – and of macroeconomic stability



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Which of these central banks is best positioned to be effective in maintaining price stability and in safeguarding against the inevitable instability of capitalism?

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Gender and the
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maintaining monetary and financial stability.

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0.1%

£895bn

3.1%

Bank Rate n
Monetary Policy

Barney Frank:

**One problem is, financial regulation
always lags financial innovation**

Ben Bernanke:

You have a neighbor, who smokes in bed... Suppose he sets fire to his house. You might say to yourself, he's irresponsible, I'm not gonna call the fire department. Let his house burn down – he deserves it.

But then of course, what if your house is made of wood, and it's right next door to his house? What if the whole town is made of wood?

Some argued for letting the fire burn. Saving the sleepy smoker would only encourage others to smoke in bed.

But the much better course is to put out the fire, punish the smoker, and if necessary, make and enforce new rules to promote fire safety.

Backdrop of steadily rising housing values feeds confidence

'Global savings glut'

Backdrop of apparent macroeconomic stability feeds confidence

What new rules for 'fire safety' did we need?

Innovations in mortgage origination

Innovations in mortgage securitization

People willing to buy houses on speculation, to flip

Loosening of standards / gaming of standards

Principle of diversification as providing safety

Assumption that mortgage securities are very safe

Complexity of overall ecosystem discourages attempts at deep understanding, in real time

Profits so wonderful, no one wants to question the overall dynamic, or its sustainability

Use of vast leverage, to make HUGE amounts of money

Causes of the Panic of 2008

- Financial innovation in the securitization of mortgages, which allowed access to much greater pools of capital to finance housing purchases
- Legalization of adjustable-rate mortgages, mortgages with interest-only payments for an initial period, and balloon-payment mortgages
- Low interest rates and low inflation, maintained over an extended period through successful monetary policies, leading to a gradual long-term increase in confidence, eventually shading into over-confidence, on the part of investors and borrowers
- Financial innovation in the streamlining and automation of mortgage underwriting processes, building on advances in credit reporting and credit scoring
- Financial innovation building on both the securitization of mortgages, and the streamlining of mortgage underwriting processes: the migration of a large share of mortgage originations from banks to **independent mortgage brokers**, who also then inadvertently became incentivized to undermine underwriting standards by helping applicants falsify qualifications like employment and income
- Steadily rising house prices in many places around the world, fed by low interest rates, the availability of lots of capital to finance purchases, and the gradual long-term accretion of confidence of investors, credit suppliers, and borrowers – with the steady rise in house prices further added to everyone's confidence, in a feedback loop
- **Mortgage brokers and originators who encouraged house buyers to take out mortgages in excess of what they could afford**, by reassuring them that when initial teaser rates expired, they could always just refinance at a new teaser rate, enabled by the rising value of their property
- **House buyers who became willing to take on amounts of mortgage debt that they knew they would have difficulty paying back**, because they perceived that risk to be offset by the expected capital gains of owning a rapidly appreciating house
- **House buyers who bought houses for more than they could afford to pay for**, or who bought houses for more than they could afford to pay for, because they perceived that the houses they bought could be flipped rapidly and at a profit, or covered by the rent covering the mortgage payments, until such time as they could flip the house at a profit
- Gradual relaxation of mortgage underwriting standards (now crowding out fraud by mortgage brokers and applicants), out of a confidence that ever-rising house prices would protect the holders of mortgage debt from loss in the event of default by borrowers
- Financial innovation (ultimately proven mistaken / fraudulent) by **banks (both investment and commercial) and others operating as mortgage securitizers**, by which lower, riskier tranches of RMBSs could be repackaged into CDOs and thereby converted into new tranches that would then be rated as much lower risk. Innovative new risk algorithms like Value at Risk (VaR) also reassure players of their safety
- **Credit rating agencies** that were willing, in exchange for fees, to ratify that risky low-rated RMBS tranches could be combined into new CDOs, with many of the new tranches in these CDOs now meriting a AAA or AA rating
- **Mortgage securitizers who actively gamed the credit rating agency risk models**, to load highly risky mortgage pools into securities in ways that they knew would fool the risk models into rating them highly
- Hugely increasing complexity and opacity, caused by the combination of all these financial innovations, which discouraged **investors in mortgage securities** from trying to figure them out or understand them deeply themselves, and encouraged them to just rely on the ratings as certified by the credit rating agencies
- Hugely increasing complexity and opacity also eventually blinding many of the **mortgage securitizers** themselves to the increasing riskiness of their own MBSs and CDOs, to the point where they increasingly held these on their own account as investments, rather than selling them all to others
- Increasing complexity and opacity also blinding **lenders in the repo market**, to the riskiness of funds they were loaning out against mortgage securities held as collateral
- Growth of **businesses operating as shadow banks** – institutions borrowing short term, lending long term – which borrowed on repo markets and invested in mortgage securities at leverage levels far beyond those allowed regulated depository institutions. Ability of these shadow banks to grow to enormous size through access to borrowed funds, thereby making enormous profits, while also creating systemic risks in the event of their own collapse. Failure of **government** to promptly and proactively extend bank supervision to, and impose capital requirements on, these shadow banks
- **Willingness of other companies (AIG) to insure MBSs and CDOs against default, via credit default swaps**, because of an assumption that these represented diverse collections of uncorrelated risks that would therefore not be prone to simultaneous collapse, and require payment all at once. Ability of AAA-rated companies (AIG), under the terms of these contracts, to not post funds as collateral against the possibility of payment in the event of default

**What new rules
for 'fire safety'
did we need?**

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Which is a more reasonable characterization of the purposes of this set of reforms?

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To stabilize capitalism so that it will be less prone to crisis in the future

Empowered the Federal Reserve to subject supervised institutions to evaluate their resiliency in adverse conditions and to drive capital requirements. Institutions are also required to maintain 'living wills' that provide for orderly liquidation, in the event of their failure. The Federal Reserve to more closely regulate off-balance sheet activities by supervised institutions. Institutions must disclose all material credit exposures to other parties, limiting such exposure to no more than 25% of capital.

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To hasten the end of capitalism so that it can be replaced by socialism

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- Established a version of the 'Volcker Rule', prohibiting government-insured banks from engaging in proprietary trading with more than 3% of their capital
- Required credit derivatives and credit default swaps be traded on exchanges or clearinghouses, to subject them to the same reporting and disclosure requirements as securities
- Established higher capital requirements for banks, and higher risk retention standards, and the regulation of asset-backed securities (MBS, CDOs), to require banks to retain 5% of the risk of these assets

On June 30, 2010, the House of Representatives passed the reforms with a vote of 237 - 192

On July 15, 2010, the Senate passed the same package with a vote of 60 - 39

On July 21, 2010, President Obama signed the reforms

To stabilize capitalism so that it will be less prone to crisis in the future

To hasten the end of capitalism so that it can be replaced by socialism

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**In 2010, 39 Senators
and 192
Representatives
voted NOT
to establish new rules
to prevent a repeat
of what happened
in the Financial Crisis
of 2008**

Characterization
of reforms?

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trading with more than 3% of their capital

credit derivatives and credit default swaps be
exchanged, clearinghouses, to subject them to
margin requirements

of
of reforms

192

Senate
package

39

Obama

v

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To hasten
the end of
capitalism
so that it can be
replaced by
socialism

The Yourek Spectrum of attitudes towards capitalism

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MARK YOREK

Capitalism is fundamentally incompatible with a healthy and sustainable economy and society, so therefore eventually needs to be replaced by something else

Capitalism is the indispensable bedrock of the economy, but is also inherently unstable and prone to occasional crisis.

Capitalism has no issues or shortcomings worth mentioning – and government is invariably counterproductive – so we should strip government out of its way and let capitalism operate with minimal constraint and limitation

A number of specific government functions are therefore absolutely vital, to maintain the stability of the economy, and to minimize unnecessary wealth destruction in crises

MAXIMUM WEALTH PRODUCTION AND ACCUMULATION

CHRONIC FAILURE TO INCENTIVIZE THE WORKFORCE TO MAXIMUM PRODUCTIVITY

FAILURE TO MITIGATE INSTABILITY; FAILURE TO PREVENT UNNECESSARY WEALTH DESTRUCTION DURING CRISES

DANGEROUSLY MISGUIDED SOCIALIST LEFT

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

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**JUST HOW IMPORTANT IS THIS ISSUE, OF THE NEED TO USE GOVERNMENT TO MITIGATE CAPITALISM'S INSTABILITY, AND TO MINIMIZE WEALTH DESTRUCTION DURING A CRISIS?
HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?**

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HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

▪ STOCK MARKET CAPITALIZATION ERASED

–But: valuations during the bubble were inflated, illusory

▪ TOTAL HOUSEHOLD WEALTH ERASED

–Real estate value erased, plus capital market losses, (i.e., includes market capitalization erased), with the same issue of bubble valuations having been inflated / illusory

▪ REAL GROSS DOMESTIC PRODUCT LOST

–Reduced production due to economic slowdown in aftermath. But: must be compared to a hypothetical ‘optimized’ sustained-steady-growth scenario, as if the crisis were somehow avoided entirely

HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

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AN EXTREMELY DESTRUCTIVE HURRICANE



~1% OF GDP

HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

AN EXTREMELY DESTRUCTIVE HURRICANE



~1% OF GDP

THE SAVINGS AND LOAN DISASTER, 1980s



**DIRECT COST TO TAXPAYERS,
PLUS LOSS OF GDP IN AFTERMATH**

3.2% OF GDP

HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

THE PANIC OF 2008, AND THE GREAT RECESSION

**2000s LEVELS OF ECONOMIC
INTERCONNECTEDNESS**

AGGRESSIVE, LARGELY EFFECTIVE
GOVERNMENT INTERVENTIONS, TO CONTAIN
AND MITIGATE ECONOMIC DESTRUCTION

HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

**LOST GDP IN
AFTERMATH**

**6% OF GDP
OVER 3
YEARS**

HOUSEHOLD WEALTH ERASED

**97% OF GDP,
RECOUPED
OVER 10
YEARS**

103

EXTREMELY DESTRUCTIVE HURRICANES

HOW MUCH WEALTH CAN BE DESTROYED, IN A CRISIS OF CAPITALISM?

THE GREAT DEPRESSION

1930s LEVELS OF ECONOMIC
INTERCONNECTEDNESS

PASSIVE, LARGELY INEFFECTIVE
GOVERNMENT INTERVENTION TO
LIMIT ECONOMIC DESTRUCTION

HOW MUCH WEALTH CAN BE DESTROYED IN A CRISIS OF CAPITALISM?

LOST GDP IN AFTERMATH

**100% OF GDP
OVER 11
YEARS**

STOCK MARKET CAPITALIZATION ERASED

(no estimate for total household wealth destroyed)

**103% OF
GDP,
RECOUPED
OVER 23
YEARS**

300 - 500

EXTREMELY DESTRUCTIVE HURRICANES

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Where are the political parties of various countries, on this spectrum?

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DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

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The Yourek Spectrum of attitudes towards capitalism

The maturation of monetary functions in the United States

	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party SUPPORTED
ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY 1860s	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY 1913	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE, LENDER OF LAST RESORT 1934	FULL CENTRAL BANK OPERATIONS BEGIN 1934-35	FED ASSERTS INDEPENDENCE TO SET INTEREST RATES 1951	CRISIS-TESTED ABILITY TO SET INTEREST RATES INDEPENDENTLY 1979 – 1980s	CRISIS-TESTED ABILITY TO INTERVENE MASSIVELY AGAINST INSTABILITY 2008
Civil War need to raise huge amounts of money to prosecute war	Panic of 1907 need to be able to react strongly to stabilize during banking panics	Great Depression need to end bank runs and enforce banking stability	Great Depression need to end severe deflation	Korean War inflation need to end subordination to Treasury	1970s inflation need to definitively kill inflation expectations	Financial Crisis need to intervene massively to avert systemic collapse
Elimination of private bank notes Currency issued on gold standard	Federal Reserve established as new entity distinct from Treasury, with technocratic governance. But a significant part of the political establishment disagrees with the need for such an institution, and with the idea that govt should ever intervene in the economy	Deposit insurance established after banking industry is devastated by runs and panics. Fed begins to act as lender of last resort to banks, with much closer bank supervision and regulation	Convertibility to gold is ended, effectively ending gold standard. Everyone required to sell their monetary gold to government. Dollar devalued from \$20.67 to \$35 to stop deflation	Until 1951, interest rates held artificially low to help limit servicing costs on massive WW2 national debt. But outbreak of heavy inflation causes need for Fed to start setting interest rates so as to actively stabilize currency value	Due to too-loose monetary policy and oil shocks, inflation surges and begins to self-perpetuate. Paul Volcker leads effort to crush inflation expectations. Very costly to economy in short run (bad recession), with heavy political criticism, but Fed succeeds in killing inflation	Vastly destructive panic breaks out in financial system, with economy on verge of a collapse at least on the scale of the Great Depression. Fed and Treasury successfully respond in force, with Congress' backing, but there is outrage and heavy political fallout in aftermath

The maturation of monetary functions in the United States

	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party LED	Democratic Party SUPPORTED
ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY 1860s	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY 1913	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE, LENDER OF LAST RESORT 1934	FULL CENTRAL BANK OPERATIONS BEGIN 1934-35	FED ASSERTS INDEPENDENCE TO SET INTEREST RATES 1951	CRISIS-TESTED ABILITY TO SET INTEREST RATES INDEPENDENTLY 1979 – 1980s	CRISIS-TESTED ABILITY TO INTERVENE MASSIVELY AGAINST INSTABILITY 2008
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Fighting for passage of TARP

Ben Bernanke

The House vote seemed a crippling setback to our efforts to end the crisis.

But then something happened. People saw their retirement accounts shrinking by the minute, and immediately, constituent support for TARP surged. And Congress heard from them.

Sobered congressional leaders regrouped and tried again, the very next day.

Sweetened by an increase in deposit insurance from \$100,000 to \$250,000 per account, on Wednesday the Senate approved the bill 74 - 25

80% of Democrats in the Senate voted YES

On Friday, the House also approved it, 269 - 171

73% of Democrats in the House voted YES

President Bush signed it that same afternoon.

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The financial reforms of 2010

- Expanded **FDIC, Fed, and SEC oversight and receivership authority** to cover a variety of additional businesses within what is known as the **shadow banking sector**: non-bank financial firms that are large enough to pose a potentially *systemic risk*
- Established the Financial Stability Oversight Council, chaired by the Treasury Secretary, to actively regulate 'too big to fail' firms and monitor systemic economic risks (stopped short of requiring the presence of systemically important financial institutions)
- Empowers the Federal Reserve to conduct regular **'stress tests'** to evaluate the financial soundness of supervised institutions in various circumstances, and to drive capital requirements for supervised institutions
 - Supervised institutions are also required to submit a **plan for rapid and orderly liquidation**
- Empowers the Federal Reserve to regulate the **balance sheet activities** by supervised institutions
 - Requirement to **disclose all major assets**, and limiting such activities to **capital**
- Rescinded Federal Reserve authority over the private sector. In the future, such authority will require a **specific act of Congress**

- Established a version of the **'Volcker Rule'**, prohibiting **government-insured banks from engaging in proprietary trading** with more than 3% of their capital
- Requires that **credit derivatives and credit default swaps be traded through exchanges or clearinghouses**, to subject them to the same standards, and the regulation of derivatives

On June 30, 2010, the House of Representatives passed the bill with a vote of 227 - 192

92% of Democrats in the House voted YES

On July 15, 2010, the Senate passed the same package with a vote of 60 - 39

93% of Democrats in the Senate voted YES

On July 21, 2010, President Obama signed the reforms into law

- Consolidated the financial regulatory apparatus to a degree, abolishing the Office of Thrift Supervision and transferring its functions to the FDIC, Federal Reserve, and the Comptroller of the Currency

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WARRIOR

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MAXIMUM WEALTH PRODUCTION AND ACCUMULATION

CHRONIC FAILURE TO INCENTIVIZE THE WORKFORCE TO MAXIMUM PRODUCTIVITY

FAILURE TO MITIGATE INSTABILITY; FAILURE TO PREVENT UNNECESSARY WEALTH DESTRUCTION DURING CRISES



American Democratic Party

DANGEROUSLY MISGUIDED SOCIALIST LEFT

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

The Yourek Spectrum of attitudes towards capitalism

The maturation of monetary functions in the United States to stabilize capitalism

Republican
Party
LED

Republican
President
SUPPORTED

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ESTABLISHMENT OF GOVERNMENT-ISSUED CURRENCY 1860s	ESTABLISHMENT OF INSTITUTION TO MONITOR ECONOMY AND COUNTER INSTABILITY 1913	PREVENTION OF BANK PANICS: DEPOSIT INSURANCE, LENDER OF LAST RESORT 1934	FULL CENTRAL BANK OPERATIONS BEGIN 1934-35	FED ASSERTS INDEPENDENCE TO SET INTEREST RATES 1951	CRISIS-TESTED ABILITY TO SET INTEREST RATES INDEPENDENTLY 1979 – 1980s	CRISIS-TESTED ABILITY TO INTERVENE MASSIVELY AGAINST INSTABILITY 2008
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Elimination of private bank notes Currency issued on gold standard	<p>Republican Party OPPOSED</p> <p>technocratic governance. But a significant part of the political establishment disagrees with the need for such an institution, and with the idea that govt should ever intervene in the economy</p>	Deposit insurance established after banking industry is devastated by runs and panics. Fed begins to act as lender of last resort to banks, with much closer bank supervision and regulation	Convertibility to gold is ended, effectively ending gold standard. Everyone required to sell their monetary gold to government. Dollar devalued from \$20.67 to \$35 to stop deflation	Until 1951, interest rates held artificially low to help limit servicing costs on massive WW2 national debt. But outbreak of heavy inflation causes need for Fed to start setting interest rates so as to actively stabilize currency value	Due to too-loose monetary policy and oil shocks, inflation surges and begins to self-perpetuate. Paul Volcker leads effort to crush inflation expectations. Very costly to economy in short run (bad recession), with heavy political criticism, but Fed succeeds in killing inflation	<p>House Republicans OPPOSED</p> <p>verge of a collapse at least on the scale of the Great Depression. Fed and Treasury successfully respond in force, with Congress' backing, but there is outrage and heavy political fallout in aftermath</p>

The maturation of monetary functions in the United States to stabilize capitalism

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**54% of Republicans
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- Empowers the Federal Reserve to conduct regular 'stress tests' to evaluate the financial institutions under various circumstances, and to drive capital requirements for supervised institutions – Supervised institutions are also required to submit a **plan for rapid and orderly liquidation**
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- Requires that **credit derivatives and credit default swaps be traded through exchanges or clearinghouses**, to subject them to the same transparency and reporting requirements
- Established **higher standards**, and the regulation of **asset-backed securities (MBS, CDOs)** – 50% of the risk of these assets must be held by investors who are prohibited from hedging their positions in 'non-qualified' prime residential mortgage-backed securities
- Empowers **credit rating agencies**, to monitor their performance, impose greater transparency and monitor for conflicts of interest in their performance
- Empowers the **Financial Protection Bureau**, to more closely monitor **consumer lending practices**, with a focus on **high-risk lending practices**
- Empowers the SEC by the investment industry to **strengthen investor protections**, and protections against **fraud**
- Consolidated the financial regulatory apparatus to a degree, abolishing the Office of Thrift Supervision and transferring its functions to the FDIC, Federal Reserve, and the Comptroller of the Currency

On June 30, 2010, the House of Representatives passed these reforms with a vote of 227 - 192

98% of Republicans in the House voted NO

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CHRONIC FAILURE TO INCENTIVIZE THE WORKFORCE TO MAXIMUM PRODUCTIVITY

FAILURE TO MITIGATE INSTABILITY; FAILURE TO PREVENT UNNECESSARY WEALTH DESTRUCTION DURING RESSIONS



American Democratic Party

American Republican Party

DANGEROUSLY MISGUIDED SOCIALIST LEFT

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

Sensate Center

The Yourek Spectrum of attitudes towards capitalism

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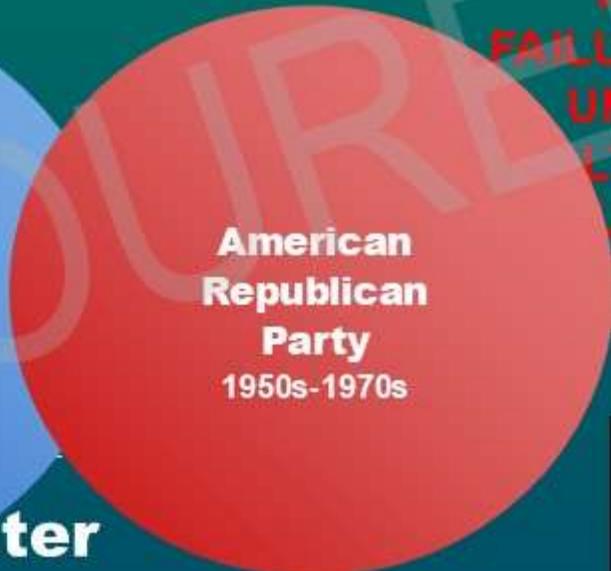
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DANGEROUSLY MISGUIDED SOCIALIST LEFT



Socialist Center

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

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FAILURE TO MITIGATE INSTABILITY; FAILURE TO PREVENT UNNECESSARY WEALTH DESTRUCTION DURING RECESIONS

Labour Party of the United Kingdom

Conservative Party of the United Kingdom

American Republican Party

DANGER OF MISGUIDED SOCIALIST LEFT

DANGER OF MISGUIDED LIBERTARIAN RIGHT

Sensibility

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DANGEROUSLY MISGUIDED SOCIALIST LEFT

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

Labour Party of the United Kingdom 1990s-2000s

Conservative Party of the United Kingdom

American Republican Party

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Liberal Party of Canada



Conservative Party of Canada



American Republican Party

DANGEROUSLY MISGUIDED SOCIALIST LEFT

DANGEROUSLY MISGUIDED LIBERTARIAN RIGHT

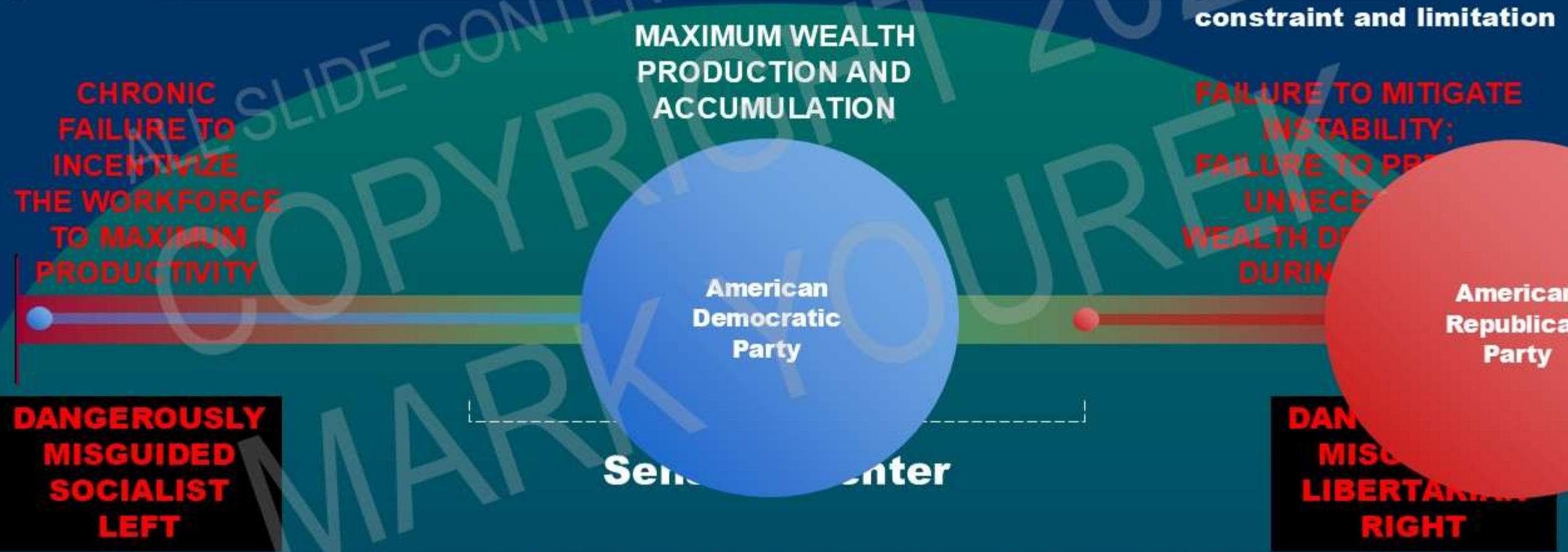
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Does the record of actual economic outcomes align with these characterizations?



The Yourek Spectrum of attitudes towards capitalism

During the postwar era, which party has had the greater propensity to implement policy combinations that are **more conducive to sustained economic growth?**

On average, which party is **better for business**, specifically?

Do **returns to equity**, i.e., overall expectations of long-term future profitability, increase more during Republican administrations, or Democratic administrations?

To say the same thing another way: **do companies tend to grow more in value** during Republican administrations, or Democratic administrations?

What does the stock market say about this?

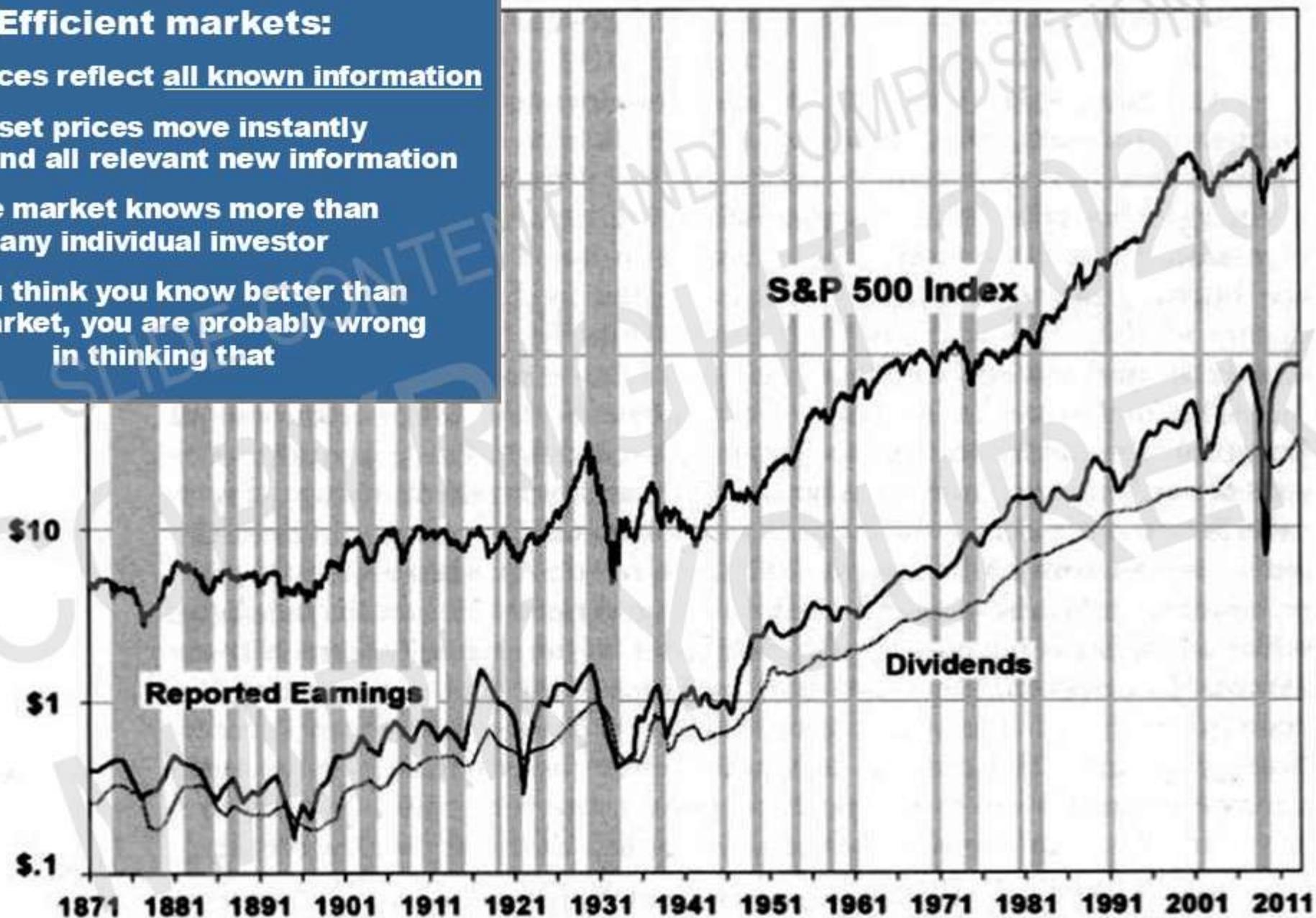
Efficient markets:

Market prices reflect all known information

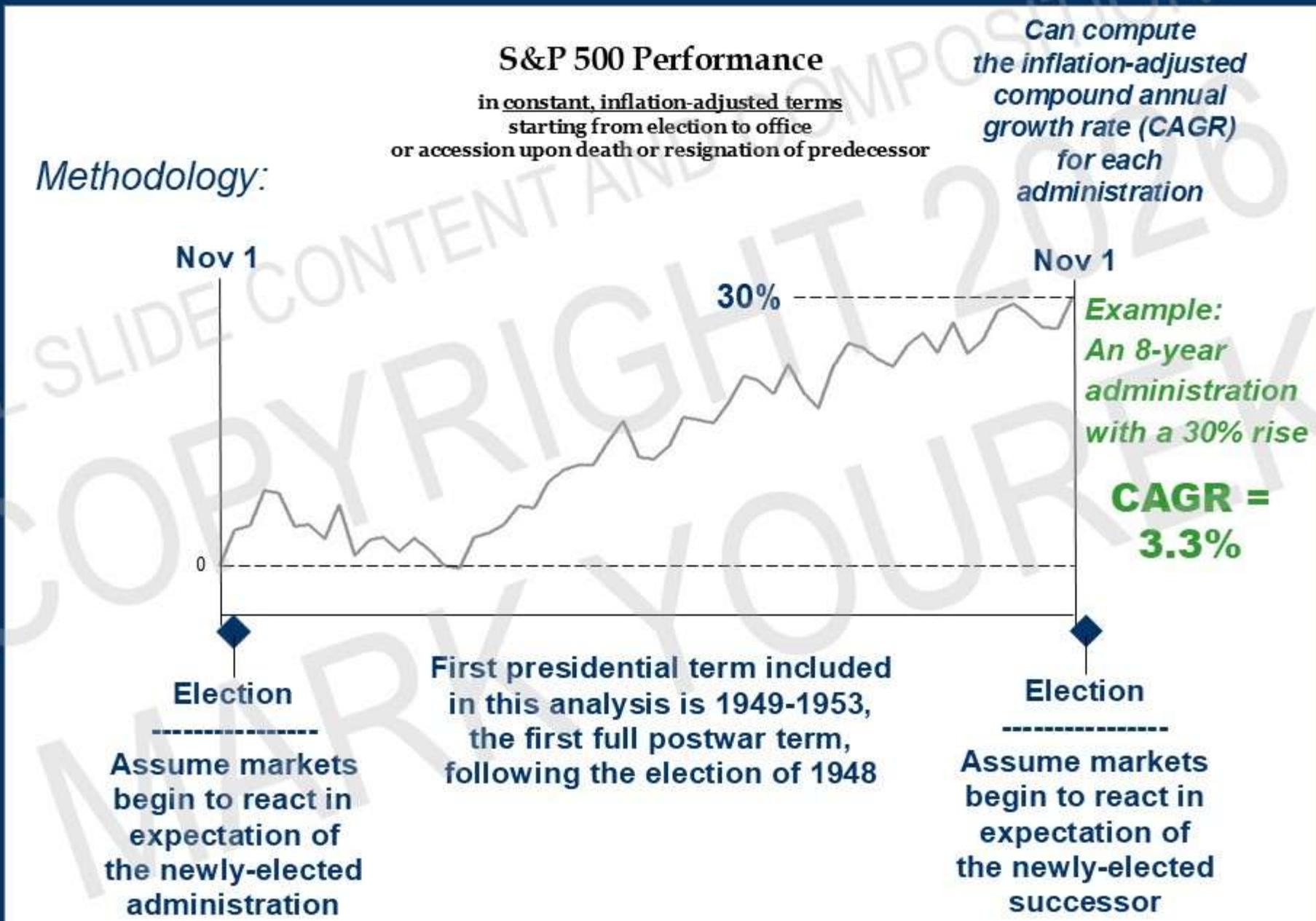
Asset prices move instantly
to impound all relevant new information

The market knows more than
any individual investor

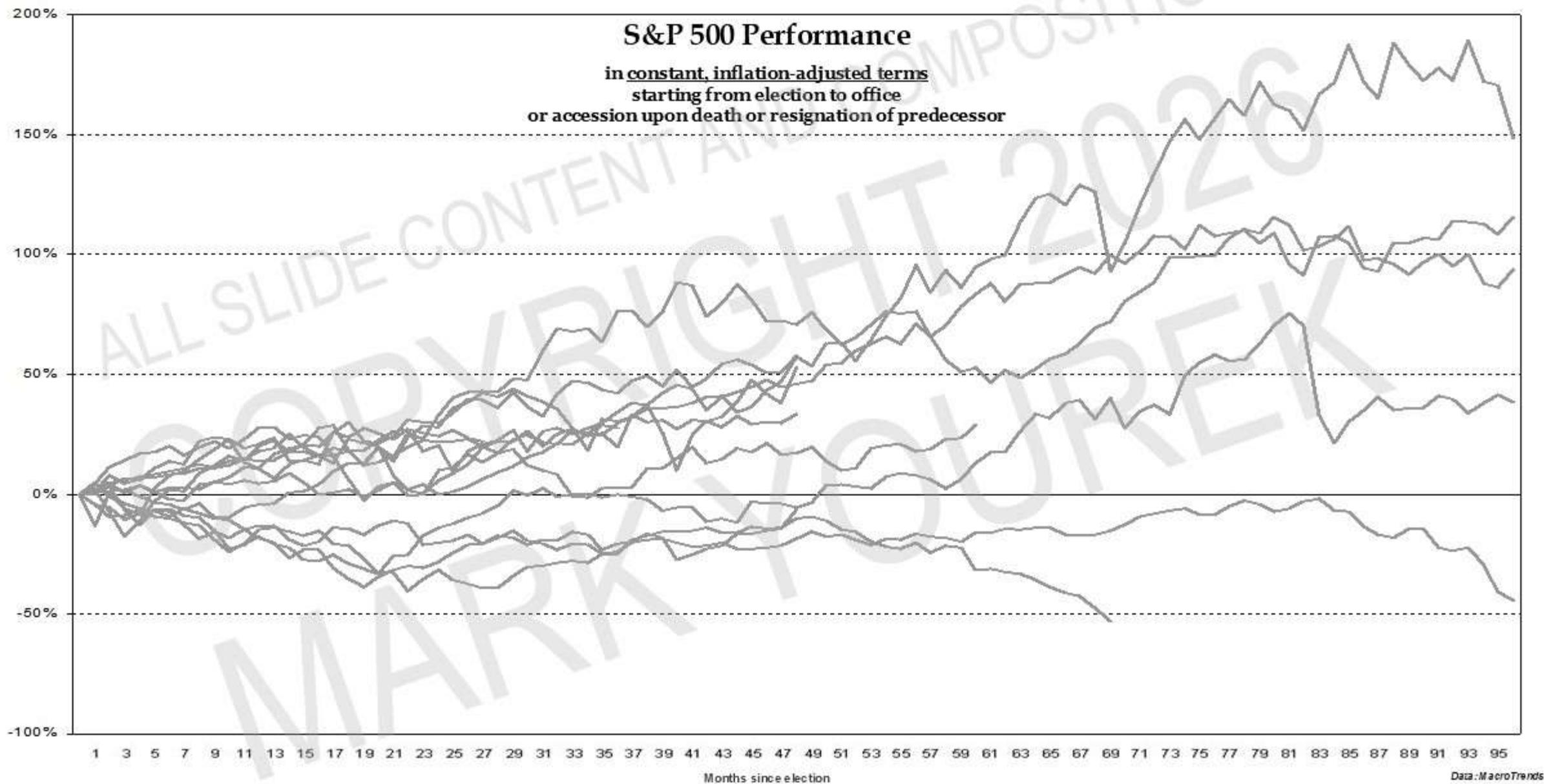
If you think you know better than
the market, you are probably wrong
in thinking that



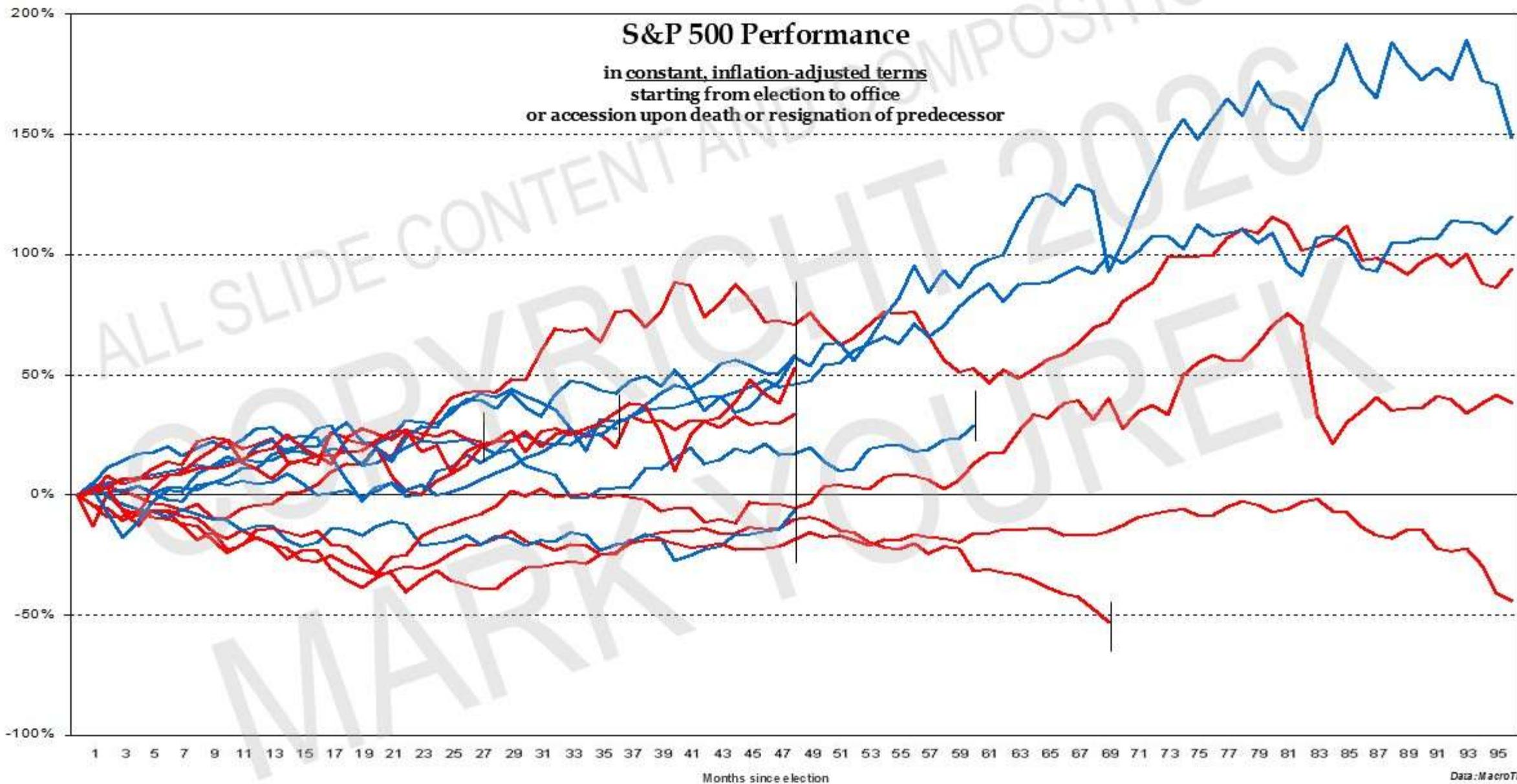
How does the US stock market perform during Democratic and Republican administrations?



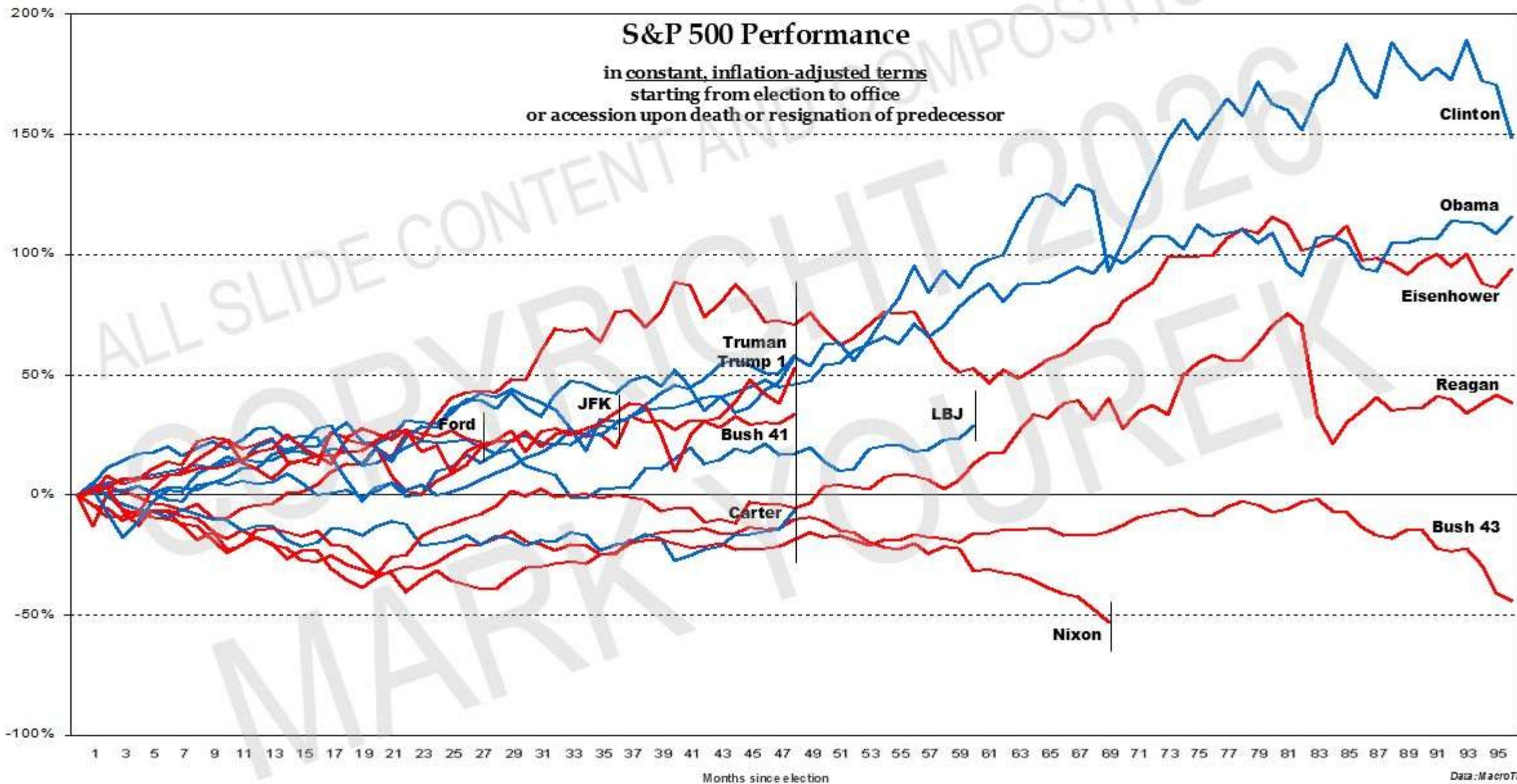
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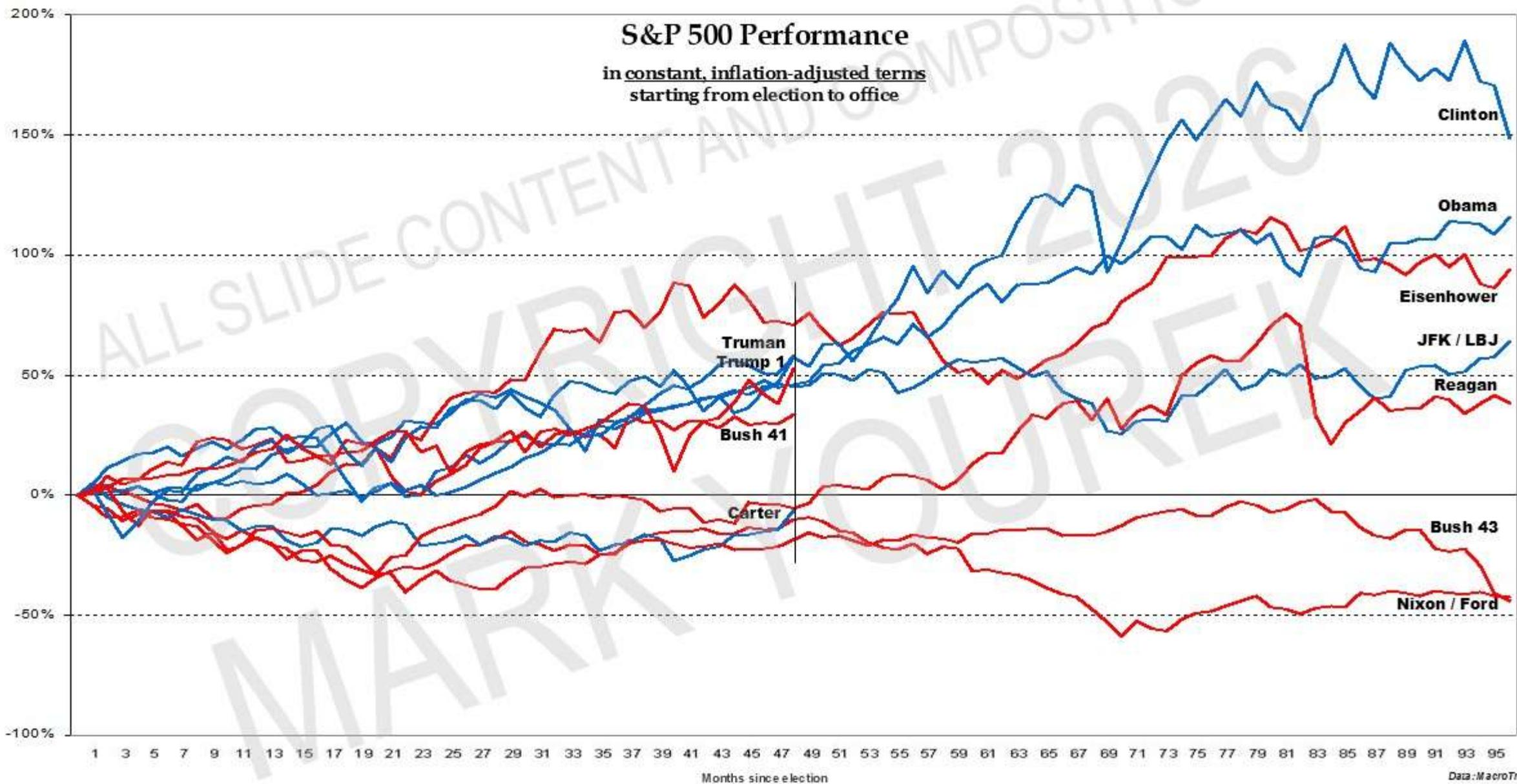
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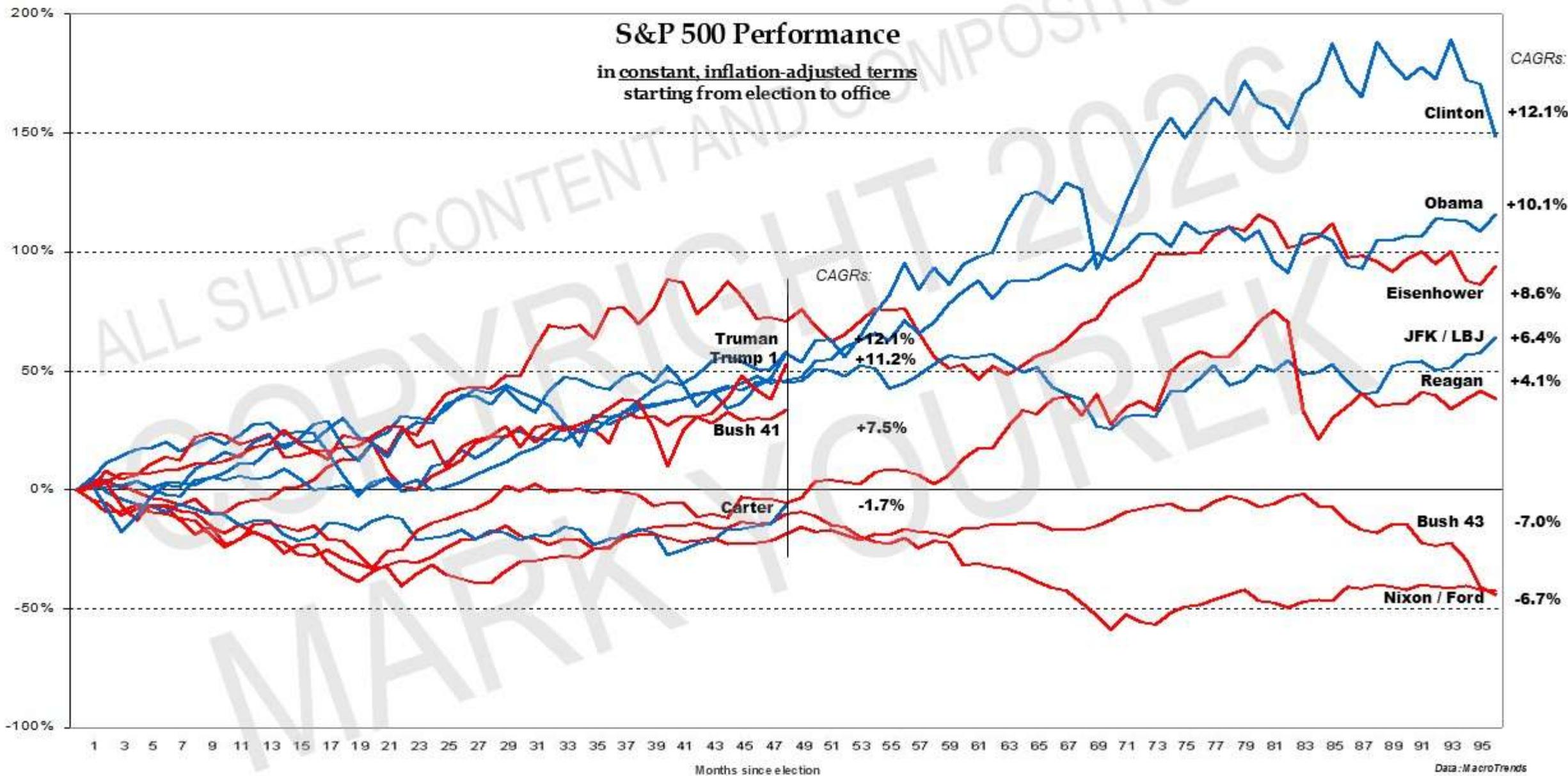
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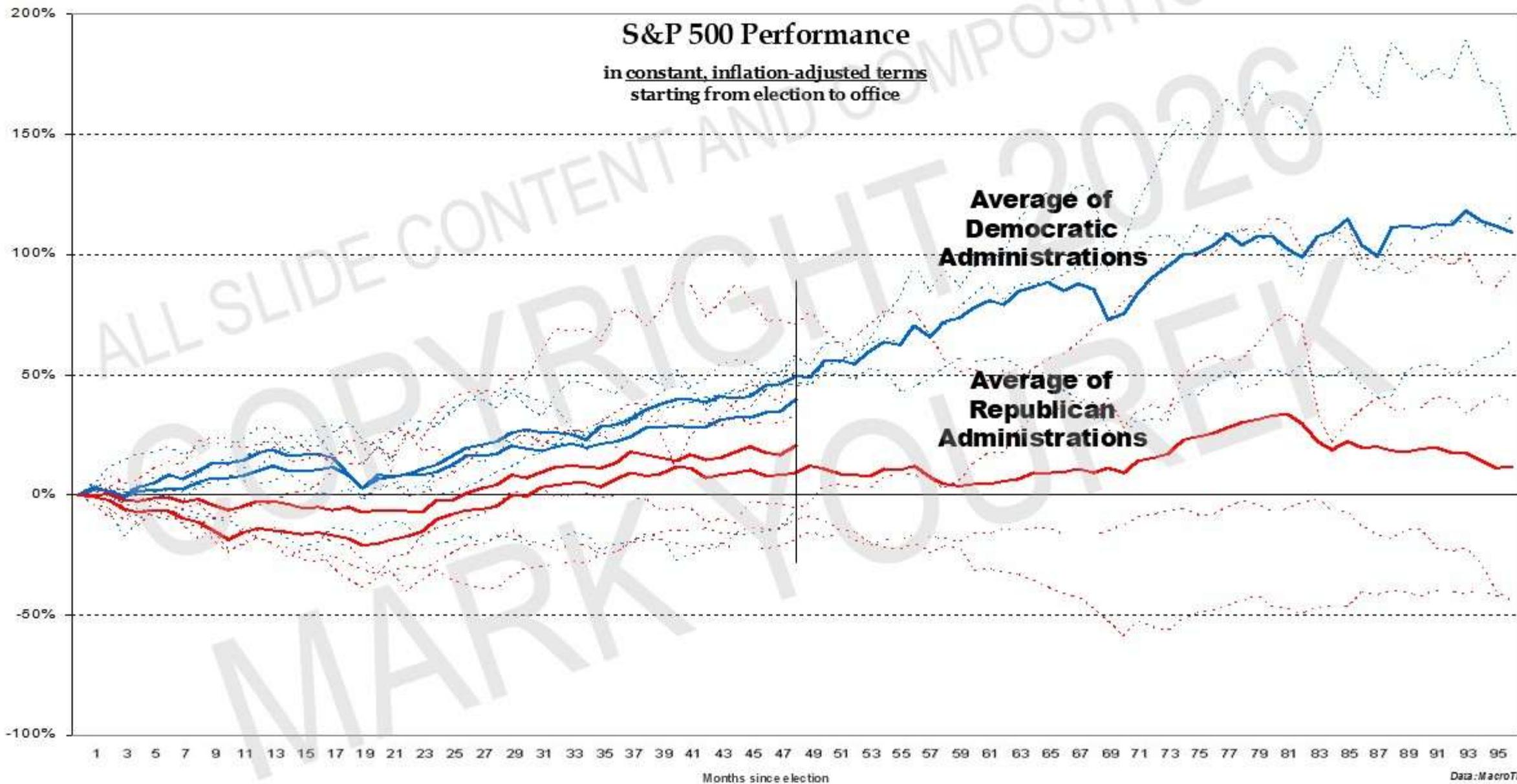
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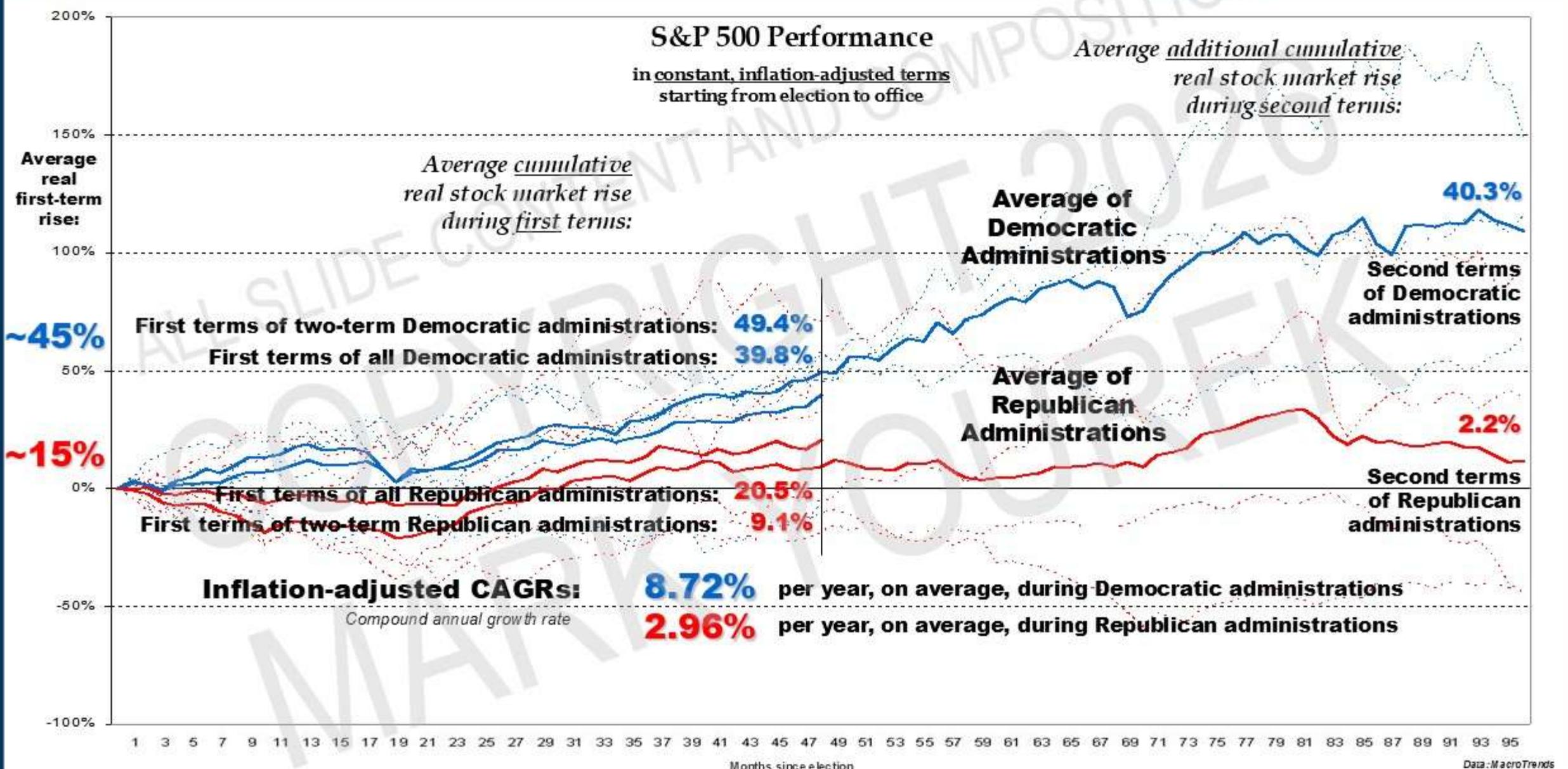
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How does the US stock market perform during Democratic and Republican administrations?



Performance during Democratic and Republican administrations?

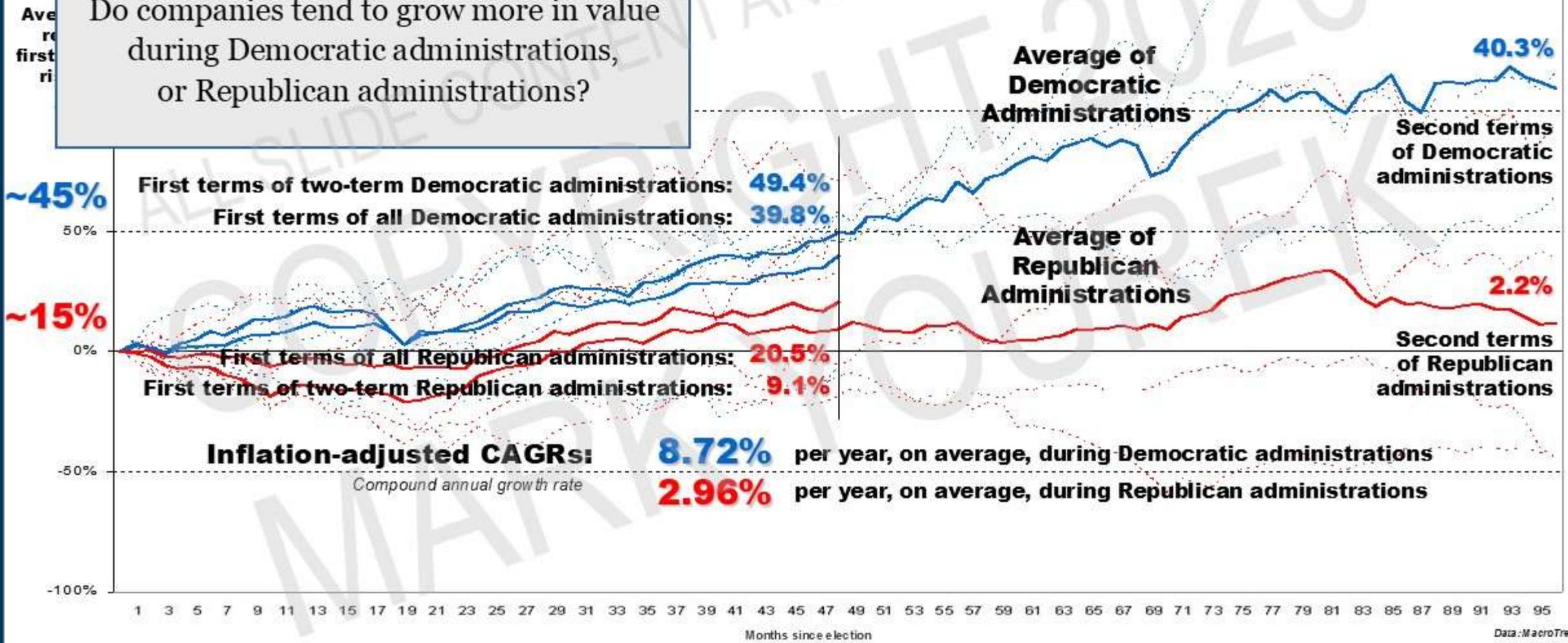
Do overall expectations of long-term corporate profitability increase more during Republican administrations, or Democratic administrations?

Do companies tend to grow more in value during Democratic administrations, or Republican administrations?

S&P 500 Performance

Constant, inflation-adjusted terms starting from election to office

Average *additional cumulative* real stock market rise during *second terms*:

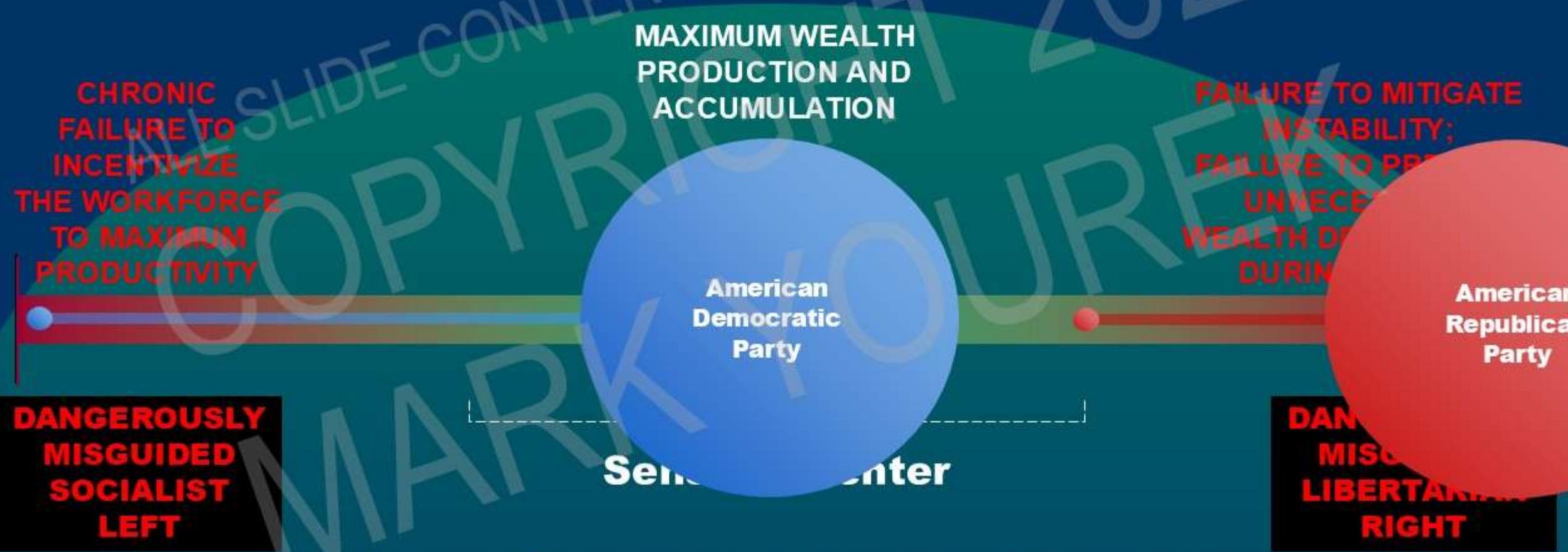


Capitalism is fundamentally incompatible with a healthy and sustainable economy and society, so therefore eventually needs to be replaced by something else

Capitalism is the indispensable bedrock of the economy, but is also inherently unstable and prone to occasional crisis.

Capitalism has no issues or shortcomings worth mentioning – and government is invariably counterproductive – so we should strip government out of its way and let capitalism operate with minimal constraint and limitation

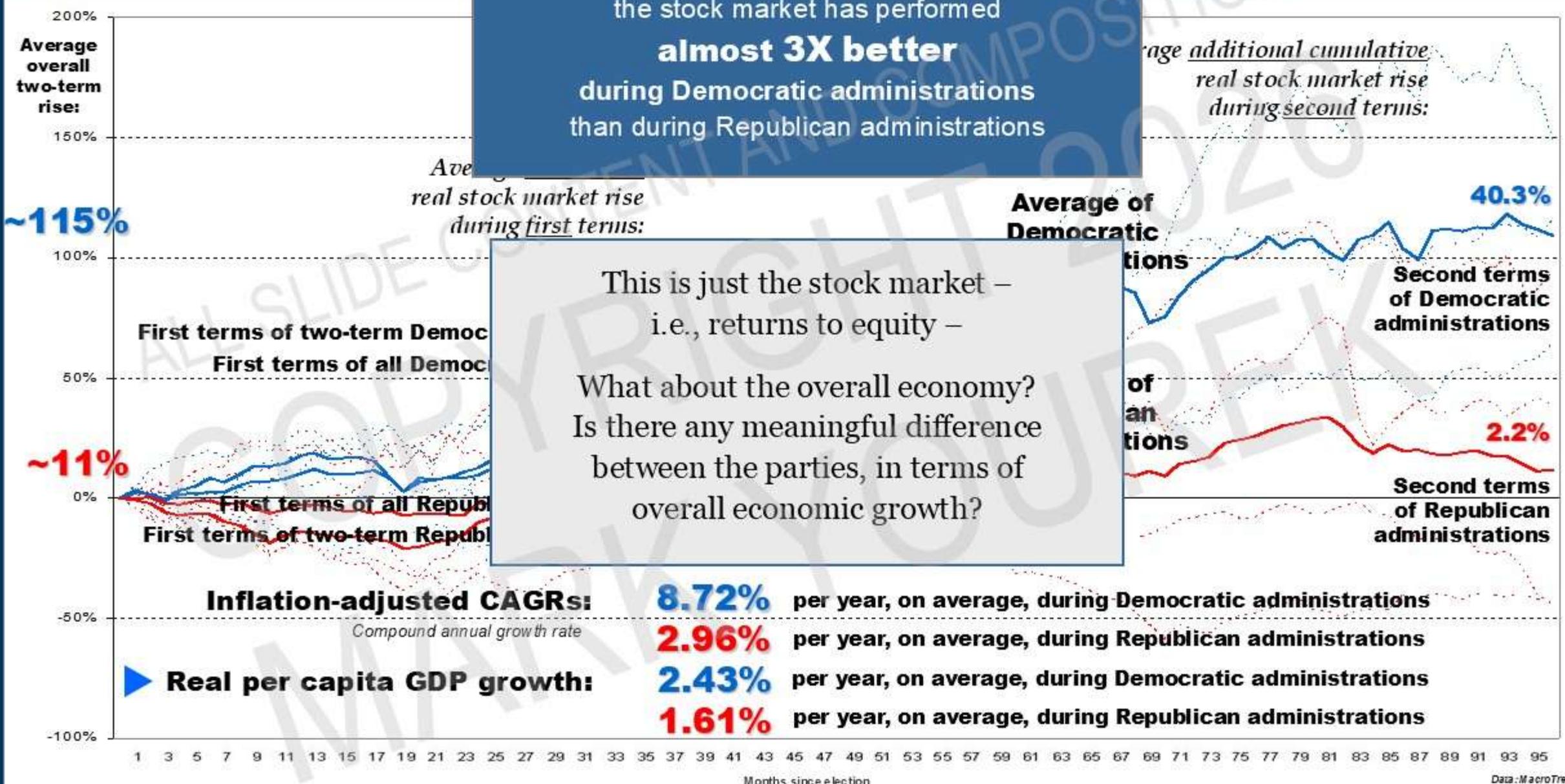
A number of specific government functions are therefore absolutely vital, to maintain the stability of the economy, and to minimize unnecessary wealth destruction in crises



The Yourek Spectrum of attitudes towards capitalism

How does the US stock market perform during Democratic vs. Republican administrations?

So far, in the postwar era, in real terms, on average the stock market has performed **almost 3X better** during Democratic administrations than during Republican administrations



This is just the stock market – i.e., returns to equity –
 What about the overall economy?
 Is there any meaningful difference between the parties, in terms of overall economic growth?

~115%

~11%

40.3%

2.2%

8.72%

2.96%

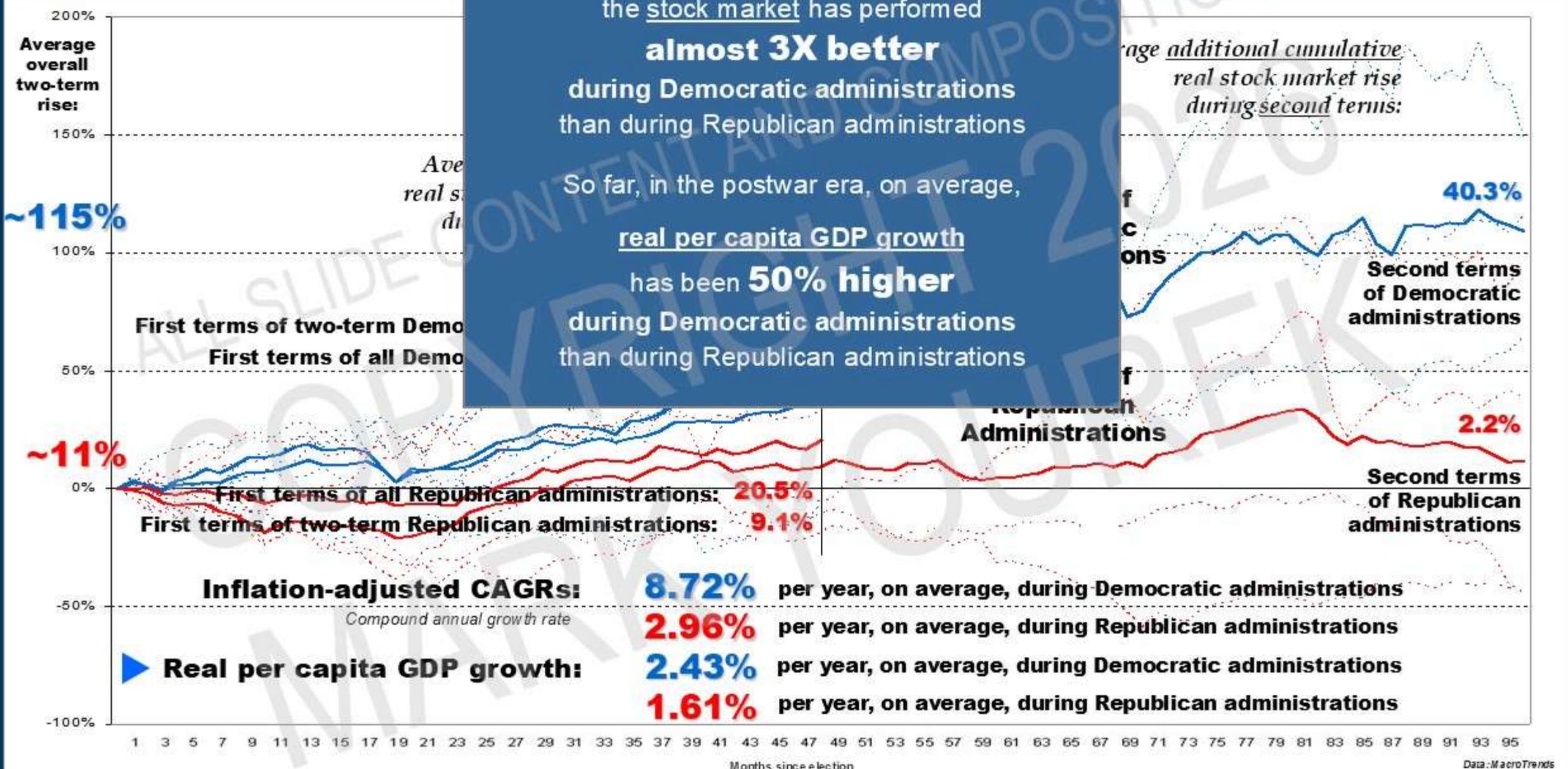
2.43%

1.61%

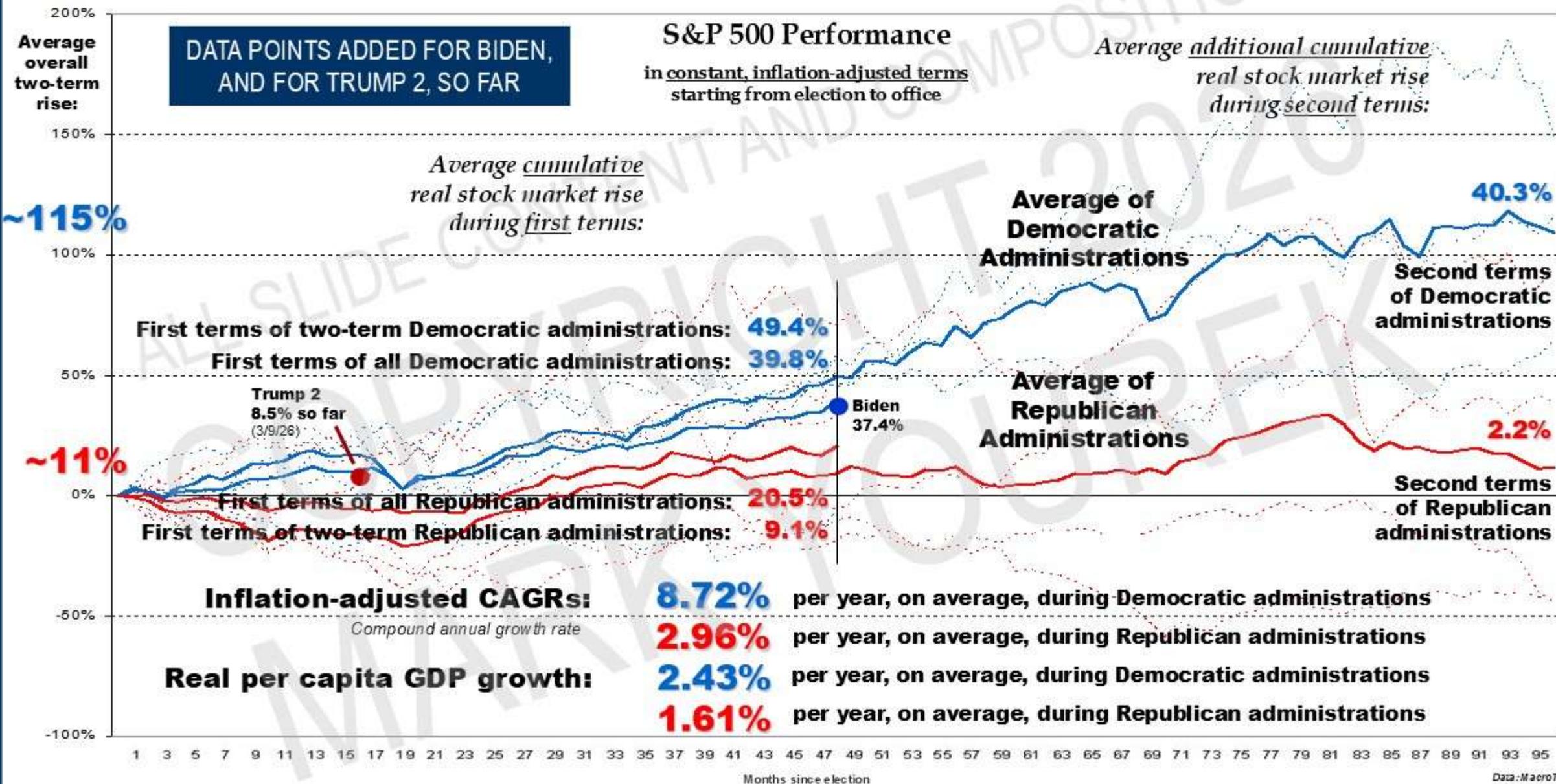
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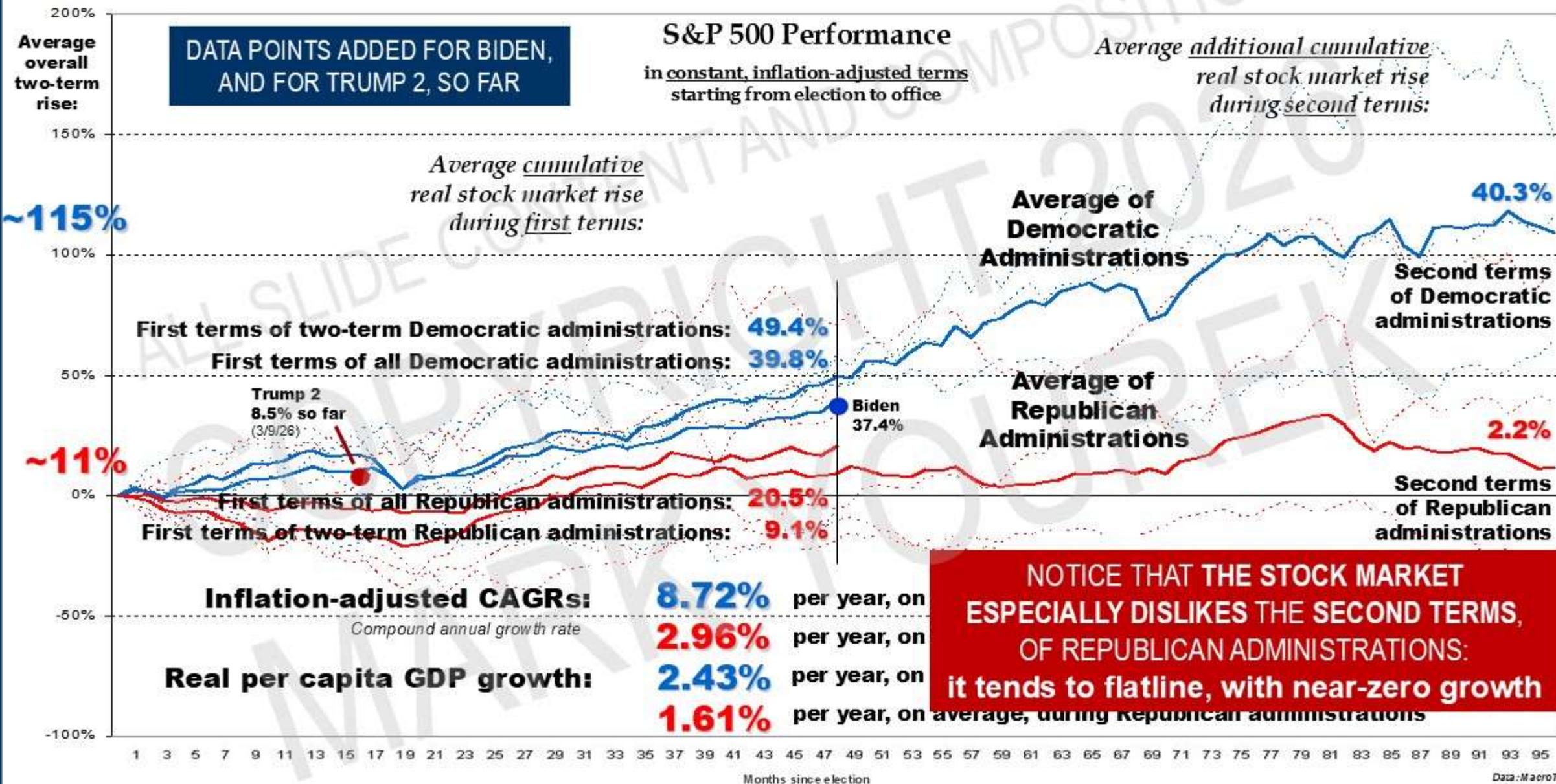
So far, in the postwar era, on average, real per capita GDP growth has been **50% higher** during Democratic administrations than during Republican administrations



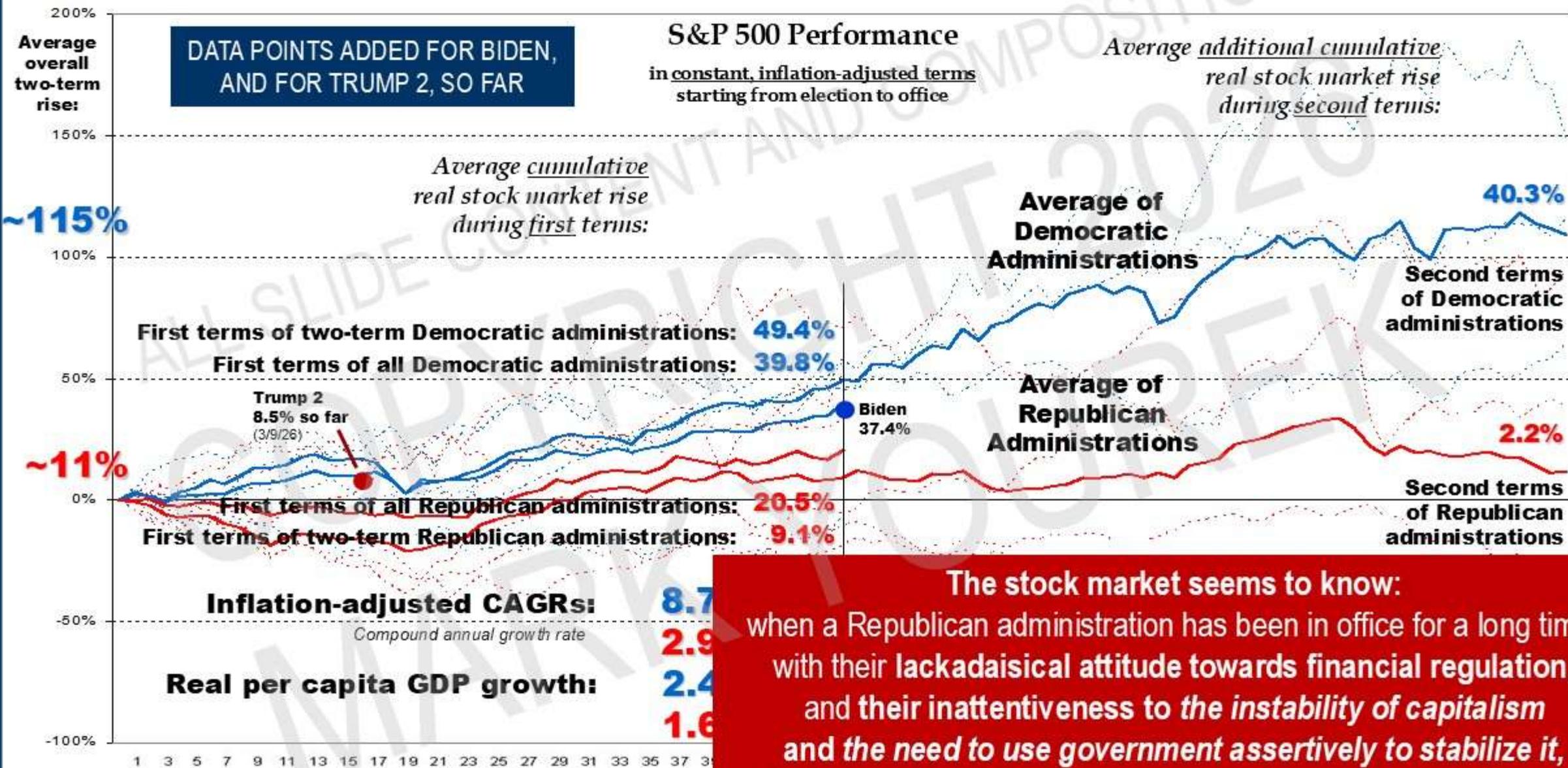
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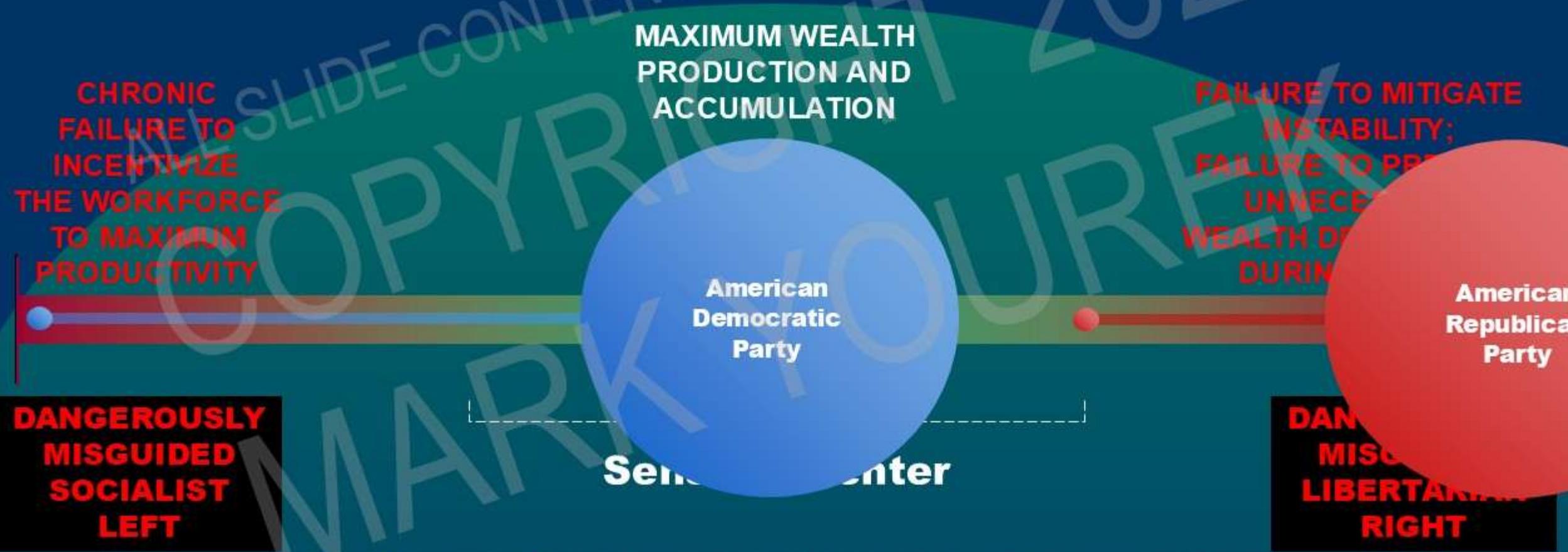
The stock market seems to know:
 when a Republican administration has been in office for a long time, with their lackadaisical attitude towards financial regulation, and their inattentiveness to the instability of capitalism and the need to use government assertively to stabilize it, this is when *the risk of a new crisis grows significantly*

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The Yourek Spectrum of attitudes towards capitalism

**Capitalism,
Government,
Money,
and the
Future of
the World**

*Finding
and Keeping
the Right Balance
in
Market-Capitalist
Democracies*