Financial Bubble Implosions. Asset Price Inflation and Social Inequality

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It is now common knowledge that the U.S. economy has in recent years been experiencing extremely uneven developments. While the financial sector has been enjoying enormously high rates of growth, the real sector is mired in stagnation or dismal growth rates. Accordingly, while the financial oligarchy is reaping the lion's share of this fantastic growth of asset-price inflation, the overwhelming majority of citizens are suffering from the systematically declining standards of living.

For example, a recent report by the Federal Reserve Bank shows that while aggregate national wealth in the U.S. rose by $1.49 trillion during the first quarter of 2014, the real economy (as measured by GDP) actually contracted by 1 percent—according to the Department of Commerce, the decline in GDP was actually 2.9 (not 1) percent. In a similar report, the Financial Times recently noted that household wealth as a whole is up 43 percent since the depths of the economic slump in 2008, despite the slow or nonexistent recovery in the labor market and an actual decline in median household income, down 7.6 percent since 2008 [1].

This obvious and growing gap between the rise of financial wealth in the absence of real growth is, of course, explained by the fantastic asset-price inflation of the past several years—a financial bubble bigger than the one that burst in 2008. Of the $1.49 trillion increase in the national wealth in the first three months of 2014, some $361 billion were due to stock price appreciation while $758 billion were due to real estate inflation. Not only has the stock price bubble largely benefited the wealthy, who disproportionately own the major bulk of stocks, but also "the increased home values were concentrated in the mansions of the super-rich, not the modest homes of working people." According to figures published by Redfin, a real estate group, from January through April 2014, "sales of the top 1 percent of US homes, those priced at $1.67 million or more, have risen 21 percent, while sales of the remaining 99 percent of homes have fallen 7.6 percent" [1].

The Financial Times, which published the Redfin figures, noted similar trends in consumer sales:

> Sales by luxury retailers such as LVMH (Louis Vuitton, Bulgari) and Tiffany rose by 9 percent; sales by retailers with mainly working class customers declined. Walmart was down 5 percent, Sears' sales fell by 6.8 percent. At the lower end, only cut-rate outlets where more and more Americans must shop to stretch their dollars saw increased sales. Dollar Tree, the largest such retailer, recorded a sales increase of 7.2 percent. . . . The newspaper observed, the gains show the effectiveness of policy in recreating the wealth lost in the recession, but its effect in boosting the economy is limited, because much of

> the benefit has gone to wealthy households that own stocks and large houses [1].

The simultaneous enrichment of the financial oligarchy, on the one hand, and the impoverishment of the masses of the people, on the other, is akin to the growth of a parasite in the body of a living organism at the expense of life-sustaining blood or nourishment of that organism. What is more, this parasitic transfer of economic blood from the bottom up is not simply the outcome of the workings of the invisible hand of market mechanism, or the blind forces of competition in a capitalist economy. Perhaps more importantly, the transfer is the logical outcome of insidious but carefully crafted economic policies that are designed to entrench neoliberal austerity economics.

Supply-Side Monetary Policy: Asset-Price Inflation as Economic Stimulus

Governments of the core capitalist countries have since the Great Depression of the 1930s applied two major types of economic stimuli: demand-side, or Keynesian, and supply-side, or neoliberal. Demand-side policies aim at boosting the purchasing power of workers and other masses of the people directly: injecting buying power into the economy through large scale investment in infrastructural projects and other employment-generating undertakings. Policy measures of this sort, which lasted from the immediate aftermath of the Great Depression and/or WW II until the late 1970s and early 1980s, served as the cornerstone of New Deal economics in the U.S. and Social-Democratic policies in other major capitalist economies.

Champions of supply-side economics also purport to offer stimulus measures to revive a stagnant economy. However, they do this in an indirect, roundabout or two-step process. The first step aims at further enriching the rich, either through fiscal policies of tax cuts for the wealthy or monetary policies of asset-price inflation, which also largely benefit the wealthy. The second step consists, essentially, of a hope or wish: it is hoped that, following the injection of additional resources into the coffers of the 1% in the first step, the 99% would then benefit from the ensuing trickle-down effects, thereby boosting aggregate demand and economic activity.

Formally, this policy was ushered in when Ronald Reagan was elected president in 1980. Initially, the architects of supply-side economics focused on fiscal policy. After successfully carrying through their project of drastic tax breaks for the wealthy, which came to be known as Reagan’s supply-side tax cuts, they then directed their attention to monetary policy as the next major redistributive tool in favor of the 1%.

Starting with Alan Greenspan as chairman of the Federal Reserve Bank to his successors Ben Bernanke and now Janet Yellen, this policy has essentially meant granting unlimited interest-free or nearly interest-free money to major banks and other Wall Street players. Although not discussed publicly, monetary policy makers of Wall Street at the head of the Federal Reserve Bank and the Treasury Department have come to view the bestowing of cheap money upon Wall Street as a monetary stimulus measure that would work through asset-price inflation and the subsequent trickle-down mechanism.

The official rationale for the injection of cheap money into the financial system is still justified, publicly, on the same grounds as the traditional Keynesian monetary stimulus: that such infusions of money into the financial sector would prompt enhanced lending to the real

sector, thereby encouraging productive investment, employment and growth. This justification of unwarranted and excessively cheap money supply is, however, premised on three major conditions: that manufacturers face a tight and expensive capital/money market; that manufacturers face or envision a strong demand for what they produce, or would produce; and that there is something akin to a partition between real and financial sectors of the economy, as it was more or less the case when the Glass-Steagall Act was in force (from 1933 to 1998), which strictly stipulated the types and quantities of investments that banks and other financial intermediaries could undertake.

None of these conditions are, however, present in today's U.S. economy. To begin with, there is no shortage of cash in the real sector; the sector seems to be, indeed, sitting on a mound of cash but not expanding production because of the austerity-generated weak demand.

While at least 25 million Americans are unemployed or working only part-time when they want and need full-time work, corporate America is sitting on a cash hoard of more than $2 trillion, refusing to invest in new production or hiring new workers, and instead engaging in speculation and stock buybacks that are more profitable for the corporate CEOs. Stock buybacks by non-financial corporations occurred at an annual pace of $427 billion in the first quarter, according to the Fed [1].

Secondly, since players in the financial sector are no longer constrained by regulatory restrictions on the types and quantities of their investment, why would they look or wait for borrowers from the real sector (who, as just mentioned, have plenty of cash of their own), instead of investing in the more lucrative field of speculation. Not surprisingly, as the regulatory constraints have been gradually removed in the past several decades, financial bubbles and bursts have become a recurring pattern.

Indeed, not only do Wall Street banks and other beneficiaries of monetary policy use the nearly interest-free money for speculative investment, but also increasingly real sector corporations divert more and more of their profits to speculation instead of production—they seem to have come to think: why bother with the messy business of production when higher returns can be garnered by simply buying and selling titles. lure of speculative profits, greatly facilitated by the extensive deregulation of the financial sector, is obviously strong enough to induce capital to abandon manufacturing in pursuit of higher returns in the financial sector. This steady transfer of money from the real to the financial sector is the exact opposite of what monetary policy-makers—and, indeed, the entire neoclassical/mainstream economic theory—claim or portray to happen: flow of money from financial to the real sector.

Capital flight from the real to the financial sector, and the divergence between corporate profitability and real investment were highlighted in an article by Robin Harding that was published in the Financial Timesof July 24, 2013. Headlined "Corporate Investment: A Mysterious Divergence," the article revealed that, in the past three decades or so, a "disconnect" has developed between corporate profitability and real investment; indicating that, contrary to previous times, a significant portion of corporate profits is not reinvested for capacity building. It is diverted, instead, to financial investment in pursuit of higher returns to shareholders' capital. Prior to 1980s, the two moved in tandem—both about 9% of GDP. Since then, and especially in the very recent years, whereas real investment has declined to about 4% of GDP, corporate profits have increased to about 12% of GDP! [2].

Financial big wigs at the helm of monetary policy in the U.S. and other major capitalist countries cannot be unaware of these facts: that most of the generous cash they inject into the financial sector is used for speculative transactions in this sector without any perceptible positive impact on the real sector. So, the question is: why, then, do they keep pumping more money into the financial sector? The answer, as mentioned earlier, is that in place of traditional Keynesian monetary policy, they seem to have now discovered a new (supply-side) monetary stimulus: trickle-down effects of asset-price inflation.

Portraying asset-price inflation as a monetary tool of economic stimulation, policymakers in the United States and other core capitalist countries are no longer averse to creating financial bubbles; as such bubbles are viewed and depicted as fueling the economy through demand enhancement effects of asset-price appreciation. Instead of regulating or containing the disruptive speculative activities of the financial sector, economic policy makers, spearheaded by the Federal Reserve Bank since the days of Alan Greenspan, have been actively promoting asset-price or financial bubbles—in effect, also further enriching the rich and exacerbating inequality.

Aside from issues such as social justice and economic security for the masses of people, the idea of creating asset-price bubbles as vehicles of economic stimulation is also unsustainable—indeed, destructive—in the long run: financial bubbles, no matter how long or how much they may expand, are ultimately bound by the amount of real values that are produced (by human labor) in an economy. Proxies of the financial oligarchy at the helm of economic policy making, however, do not seem to be bothered by this ominous prospect as they have apparently discovered something akin to an insurance protection scheme that would shield the market and major financial players against the risks of financial bubbles.

Insuring Financial Bubbles: Creating a New Bubble to Patch-up a Burst one

Champions of the policy of asset-price bubbles as economic stimuli do not seem to be worried about the destabilizing effects of the bubbles they help create, as they tend to believe (or hope) that the likely disturbances and losses from the potential bursting of one bubble could be offset by creating another bubble. In other words, they seem to believe that they have discovered an insurance policy for bubbles that burst by blowing new ones. Professor Peter Gowan of London Metropolitan University describes this rather perverse strategy in the following words:

Both the Washington regulators and Wall Street evidently believed that together they could manage bursts. This meant that there was no need to prevent such bubbles from occurring: on the contrary, it is patently obvious that both regulators and operators actively generated them, no doubt believing that one of the ways of managing bursts was to blow another dynamic bubble in another sector: after dot-com, the housing bubble; after that, an energy-price or emerging market bubble, and so on [3].

Randall W. Forsyth of Barron's likewise points out, "always contended that monetary policymakers can . . . clean up the after-effects of the bust—which meant reflating a new bubble, he argued." It is obvious that this policy of effectively insuring financial bubbles would make financial speculation a win-win proposition, a proposition that is aptly called "moral hazard," as it encourages risk-taking at the expense of others—in this case of the 99%, since the costs of bailing out the "too-big-to-fail" gamblers are paid by austerity cuts. that "the Fed would bail out the markets after any bust, they went from one excess to another," Forsyth further points out. "So, the Long-Term Capital Management collapse in

1998 begat the easy credit that led to the dot-com bubble and bust, which in turn led to the extreme ease and the housing bubble” [4].

The policy of protecting major financial speculators against bankruptcy shows, among other things, that the neoliberal financial architects of recent years have jettisoned not only the New Deal–Social Democratic policies of demand management but also the free-market policies of non-intervention, as advocated, for example, by the Austrian school of economics. They tend to be interventionists when the corporate-financial oligarchy needs help, but champions of laissez-faire economics when the working class and other grassroots need help. Prior to the rise of big finance and its control of economic policy, bubble implosions were let to run their course: reckless speculation and mal-investments would go bankrupt; the real economy would be cleansed of the deadweight of the unsustainable debt; and (after a painful but relatively short period of time) the market would reallocate the real capital to productive uses. In the era of big finance and powerful financiers, however, that process of creating a “clean slate” is blocked because the financial entities that play a critical role in the creation of bubbles and bursts also control policy.

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Notes

[1] As cited in Patrick Martin, “Wealth report shows deepening social polarization in US,” <http://www.wsws.org/en/articles/2014/06/07/weal-j07.html>; see also Rob Uri, “Monetary Policy as Class Warfare, Revisited,” < http://www.counterpunch.org/2014/05/23/monetary-policy-as-class-warfare-revisited/>.

[2] Robin Harding, “Corporate investment: A mysterious divergence,” <http://www.ft.com/intl/cms/s/0/8177af34-eb21-11e2-bfdb-00144feabdc0.html#axzz2dN45MG7r>.

[3] As cited in Ismael Hossein-zadeh, Beyond Mainstream Explanations of the Financial Crisis(Routledge 2014), p. 16.

[4] Randall W. Forsyth, “Ignoring the Austrians Got Us in This Mess,” <http://online.barrons.com/article/SB123680667244600275.html>.

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