Global Inequality, Wealth Concentration and the Subprime Crisis: A Marxian Commodity Theory Analysis

Photis Lysandrou

ABSTRACT

This article argues that the driving force behind the structured credit products that triggered the financial crisis was a global excess demand for securities, and that key to the build-up of this demand was the huge accumulation of private wealth. The argument is Marxian inasmuch as it builds on Marx’s insight that crisis is endemic to capitalism because the commodity form by its very nature gives rise to the possibility of a separation between supply and demand, and because periodic realization of this separation arises out of the fact that the value of the labour capacity is generally less than the value of the output produced by it. The argument is an unorthodox Marxian one in that its specification of the mechanism through which the effects of exploitation feed into crisis is different from that specified by Marx himself. While the separation between supply and demand is central to the crisis transmission mechanism described here, the difference is that the commodities in question are financial commodities rather than material commodities. Prevented from surfacing ‘below’ in GDP space in the form of an excess supply of material goods, the effects of exploitation have instead surfaced ‘above’ in capital market space in the form of an excess demand for debt securities.

INTRODUCTION

The global financial crisis that broke out in the summer of 2007 did not occur simply because subprime-backed securities had got into the financial system. It occurred because the volume of these toxic securities had grown to the point where the system could no longer cope. Given that it was hardly possible for this point of critical mass to have been reached without the pressure of demand, one would have expected the blame for the subprime crisis to have been placed as much on the investors buying the securities as on the banks that supplied them. This has categorically not been the case. In the literature on the crisis, attention has been concentrated to such an extent

I wish to thank Thomas Goda for his help in preparing this paper and the editors of this journal for their useful comments.
on the supply side factors pushing the growth of the subprime products as to leave the demand pull factors largely shrouded in mystery.

According to the mainstream view of the crisis, its root cause lay in the lax behaviour of the banks as manifested in weak lending standards, poor risk assessment methods and excessive leverage (Borio, 2008; Goodhart, 2008; Obstfeld and Rogoff, 2009; Wolf, 2009). Insofar as the wider economy enters into the picture, it does so in ways that bolster this supply-side story, one argument being that the period of the so-called ‘great moderation’ contributed to the undervaluation and mispricing of risk, and another being that the build-up of a ‘savings glut’ in Asia contributed to the unusually low borrowing costs and the resulting excessive leverage in the Western banking system (Bernanke, 2004, 2005; Obstfeld and Rogoff, 2009; Wolf, 2009). By contrast, the heterodox view tends to identify the malignant influences of neoliberal ideology rather than the benign influences of macroeconomic stability as the chief source of the various failures that led to the undervaluation of risk and consequent over-supply of the subprime-backed securities (Blackburn, 2008; Blankenburg and Palma, 2009; Dore, 2008; Kregel, 2008; Randall Wray, 2008; Wade, 2008). This said, however, heterodox economists are generally at one with their mainstream counterparts in underestimating the external pressures on the banks to supply these securities. One can search the heterodox explanations of the subprime crisis looking long and hard for any serious discussion of the role played by investors in the growth of the subprime products, but that search will be in vain.

There are two explanations for this state of affairs. The first concerns the treatment of securities. These tend to be viewed from the standpoint of the organizations issuing them and from this standpoint there can never be an excess demand for securities because the greater the supply of funds associated with that demand, the lower borrowing costs will be and hence the more willing organizations will be to issue securities.1 The fact is that most investors today treat securities as commodities in their own right rather than merely as a means of financing the provision of other commodities and from this standpoint an excess demand problem can arise at the point where organizations are not issuing securities with a sufficient wealth storage capacity to accommodate the build-up of wealth. The second explanation concerns the treatment of inequality. Insofar as inequality is brought into the story of the subprime crisis it is the uneven distribution of income that is the focus of attention while the flipside of that distribution, the concentration of personal wealth, is largely ignored. Although the steep rise in income inequality can explain the equally steep rise in the household demand for bank credit, it

---

1. Thus Borio (2008: 13) states that ‘an increase in supply tends to reduce the equilibrium price and is hence self-equilibrating. By contrast, in the financial sector, increases in the supply of funds (e.g. credit) will, up to a point, create their own demand, by making financing terms more attractive, boosting asset prices and hence aggregate demand. In a sense, a higher supply (of funding liquidity) ultimately generates its own demand’.
cannot explain the securitization of this credit, its transformation from a relational and non-tradable form into a commoditized and tradable form. For help with this explanation, one has to go to the other side of the inequality equation, to the accumulating pools of wealth seeking a suitable form of storage.

This contribution argues that the chief driving force behind the creation of the structured credit products that triggered the crisis was a global excess demand for investable securities and that key to the build-up of this excess demand was the huge accumulation of private wealth. The argument is an unorthodox Marxian one. It is Marxian because it builds on Marx’s insight that crisis is endemic to capitalism as a commodity-producing system because the commodity form by its very nature gives rise to the possibility of a separation between supply and demand, and because periodic realization of this separation arises out of the fact that the value of the labour capacity is generally less than the value of the output produced by it. It is unorthodox because its specification of the mechanism through which the effects of exploitation feed into crisis is different from that specified by Marx himself. While the separation between supply and demand is central to the crisis transmission mechanism described here, the difference is that the commodities in question are financial commodities rather than material commodities. Prevented from surfacing ‘below’ in GDP space in the form of an excess supply of consumer or producer goods, the effects of exploitation have instead surfaced ‘above’ in capital market space in the form of an excess demand for debt securities.

Besides this introduction and a brief conclusion, the article has three main sections. These, in turn, explain the general reasons behind the emergence of a global excess demand for securities; highlight the pivotal role played by the global concentration of wealth in the emergence of this excess demand problem; and spell out some policy implications.

THE POSSIBILITY OF THE SUBPRIME CRISIS: THE GLOBAL EXCESS DEMAND FOR SECURITIES

The financial products at the epicentre of the financial crisis that broke out in the summer of 2007 were Collateralized Debt Obligations, or CDOs — structured credit products that were created by pooling mortgage-backed securities (mainly comprising those backed by subprime and other non-conforming mortgage loans) with other asset backed securities as collateral. These products broke the cardinal rule of commodity exchange, that of transparency. For any entity to become a commodity that is priced and traded against market standards, the conditions governing the provision of that entity must be sufficiently transparent to allow for common recognition of its characteristics. The irony is that the same credit enhancement techniques that were used in the attempt to make CDOs safe actually helped to make
them too opaque and hence too difficult to value accurately to any market standard. When it transpired that it was the opacity of these products that had contributed to the breakdown in trust between the large commercial banks, that in turn set in motion the liquidity–solvency crisis spiral that unfolded over 2007–8; it was the banks and all those closely associated with them in originating and distributing the CDOs that took the major blame for causing the crisis. This was the wrong conclusion. While the banks and their associates cannot be absolved from blame, the root cause of the subprime crisis lay in the current structure of the global capitalist system rather than in any failings on the part of certain individuals or organizations. In developing this argument, a good point of departure is to look at Marx’s insights into capitalism as a commodity producing economy.

Although elements of commodity relations appear in virtually all pre-capitalist societies, Marx identifies capitalism as the only genuine commodity system because it is only with the advent of capitalism that the commodity principle is stretched to the point where production for the market is the norm rather than the exception, a development that is in turn contingent on the fact that the commodity principle is also deepened to encompass not only material goods and services but also the capacities for producing them. Modern day capitalism essentially marks a culminating stage in the commodity ‘stretching’ and ‘deepening’ processes, the former because the commodity principle now encompasses the majority of the material goods that are produced in the world and the latter because the same principle now also encompasses securities, financial claims on the organizations within which many of the capacities for production are deployed (Lysandrou, 2005). This latter development has only occurred in the past four decades — even though capital markets have been evolving for more than four hundred years — because it is only in this recent period that institutional investors have grown to become the dominant force in the markets. In all previous periods the typical investor was an individual, a bank, a corporation or a government and, whatever else may separate these investors, their common characteristic is that they do not treat an investment portfolio as a product to be marketed to the public. However, this is exactly how most institutional asset managers must treat their portfolios today if they are to accommodate the new mass demands made upon them while also containing the costs of that accommodation (Grahl and Lysandrou, 2006).

It is usually the case that when an industry grows in scale there is a corresponding shift towards the standardization of products and processes, and institutional asset management is no exception. In place of the broad-based and discretionally managed portfolio that was the norm when asset management was still in its infancy, more typical today is the portfolio that is managed to a narrowly specified investment rule or target. The large investment firms now tend to organize their individual portfolio managers along a return-risk continuum that begins with the giant beta factory portfolios which simply aim to combine average market returns with average market
risks and where all the other portfolios seek to generate a certain additional amount of return at the cost of accepting an equivalent amount of additional risk. Through the separation and narrowing of portfolios the investment firms are better placed to satisfy the different risk appetites of their wholesale or retail clients while also being better able to match the rewards paid to individual portfolio managers for their performance. However, the flipside of this standardization of asset management is that it entails the imposition of various constraints on security-issuing organizations that are far tighter than any that have been imposed in the past. As long as institutional investors had substantial discretion in how they constructed and managed portfolios, they could afford to extend the same degree of discretion to those issuing securities. On the contrary, now that institutional investors are constrained to keep portfolios strictly to the terms as laid down in an investment mandate or fund prospectus, so must they similarly constrain the actions of security issuers if they are to control the risk characteristics of the individual securities that comprise the portfolios. The upshot is that what now goes on in the capital markets is in principle no different to what goes on in the product markets: just as households and firms buying goods or services for consumption or production purposes expect them to meet certain standards regarding material quality, so institutional investors buying securities for portfolio management purposes expect these to meet certain standards regarding risk quality.

The problem with these new standards is that while necessary to the commoditization of securities they at the same time exert a restraining effect on their global supply. There are two routes through which this effect is transmitted. The first is through the impact on the behaviour of individual governments and corporations. There have always been certain norms regarding the amounts of securities that governments and corporations can safely issue, but what is different today is not only that these norms have become regularized and harmonized at the global level, but also that there are now new ways for monitoring and measuring any deviations from these norms. When security issuers know that any deviation on their part is certain to be factored into their ratings and thus into their capital-raising costs, they are more likely to try to conform in order to limit the costs of deviation and conformity, including the slowing down of security issuance. The second route is through the impact on regional capital market development. As shown in Figure 1, in 2006 the emerging market economies (EMEs) as a whole accounted for 30 per cent of world output but for only 14 per cent of the global stock of securities (and a mere 9 per cent of debt securities). Part of the story behind this imbalance is that the policy makers in these regions have deliberately held capital market growth in check because of a continuing preference for alternative, bank-based forms of finance. However, another part of the story is that the establishment of a market for securities that is genuinely deep and liquid requires a legal, accountancy and governance framework that is orders of magnitude
stronger and more transparent than that required for the material product markets.

The restraining effect on the rate of security issuance need not cause a problem as long as that rate can keep up with the growth in aggregate demand. This was the case for much of the period after 1980 as would appear to be shown by the more rapid growth in the supply of debt and equity securities relative to the growth of world GDP and to the growth of bank deposit money (see Figure 2). However, the situation had changed radically by the turn of the century as a result of the rise in the global demand
Global Inequality and the Subprime Crisis

Figure 2. Growth of Global Financial Stocks (US$ Trillions)


The peculiarities in international capital flows observed in the period between 2001 and 2006 tie in with the growth in the global imbalance between the aggregate supplies of securities on the one hand and aggregate demand on the other. As can be seen in Figure 3, net capital outflows from the EMEs rose sharply after 2001 with the major part of these finding their way into the US. A number of commentators have put these observed peculiarities down to differences in regional behavioural patterns, the central argument being that the Americans were not saving enough while the Asians and others for their part were saving too much (see Wolf, 2009). The view here is that these peculiarities had less to do with behavioural differences than with capital market asymmetries. Given the comparatively small size of

for securities emanating not only from institutional investors (who obviously needed securities in increasing volumes merely in order to carry out their basic asset management function) but also from a number of other sources including commercial banks (many of whom, in response to the changes in household saving patterns, were now competing for asset management business), governments (mainly comprising those of EMEs who not only held substantial amounts of US treasuries as currency reserves but were increasingly investing in the securities markets through recently established Sovereign Wealth Funds) and high net worth individuals. Table 1 shows the relative size of each of these major sources of demand for securities in 2006.
Table 1. Major Holders of Securities, 2006 (US$ Trillions)

<table>
<thead>
<tr>
<th></th>
<th>Total Assets</th>
<th>Securities</th>
<th>Alternative Investments (inc. Hedge funds)</th>
<th>Other Assets (cash, real estate, etc.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Institutional Investors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) PFs</td>
<td>21.6</td>
<td>17.3</td>
<td>1.3</td>
<td>3.0</td>
</tr>
<tr>
<td>(b) MFs</td>
<td>19.3</td>
<td>17.4</td>
<td>0.8</td>
<td>1.1</td>
</tr>
<tr>
<td>(c) ICs</td>
<td>18.5</td>
<td>14.8</td>
<td>1.1</td>
<td>2.6</td>
</tr>
<tr>
<td>2. Banks</td>
<td>74.4</td>
<td>37.2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3. Governments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Reserves</td>
<td>5.4</td>
<td>4.9</td>
<td>0</td>
<td>0.5</td>
</tr>
<tr>
<td>(b) SWFs</td>
<td>1.9</td>
<td>1.5</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>4. HNWIs</td>
<td>37.2</td>
<td>19.3</td>
<td>3.7</td>
<td>14.1</td>
</tr>
</tbody>
</table>


the EME capital markets, it was inevitable that the accumulating surpluses earned from oil or other non-oil exports would flow outwards, and given the huge size of the US capital markets it was equally inevitable that it would be these markets that would be the chief recipients of the EME surpluses. While a portion of these surpluses was directed into the US equity markets, the major part was directed into the US treasury and corporate bond markets (see Figure 4). The consequence of this influx of foreign funds into the US bond markets was that the downward pressure on yields was stronger and maintained for longer than would otherwise have been the case (see Figure 5).

Faced with the growth of competitive demand and corresponding low yields in the US government and corporate bond markets, institutional investors had to find additional stocks of debt securities in which to invest, and given the limited availability of such stocks outside of the US, it was the US banks that had to be relied upon to provide an alternative source of supply. One solution that the latter came up with was to step up the rate of issuance of asset-backed securities (ABS). These securities have been around since the 1970s, and yet about half of the total stock outstanding at the end of 2007 had been issued in the preceding five years (see Figure 6). Most commentators have concentrated attention on the various supply-side factors behind the rise in ABS issuance, the argument being that while the sharp fall in the federal funds rate after the ‘dot.com’ crash helped to boost property prices and the household demand for mortgage loans, it also gave the banks an added incentive to move further towards the ‘originate and distribute’ model of mortgage lending as the gains made from fees and commissions increasingly outweighed those made from interest income. However, it is likely that demand-side factors played the more important role in driving up the rate of ABS issuance as attested by the ABS spread over US treasuries (see Figure 7). This spread should have widened after 2001 given that the rate of issuance was growing at an unprecedented high rate. The fact that, on the contrary, it continued
to fall right up to 2007 reflected the heavy build-up of demand for asset-backed securities from institutional investors who were searching for yield.²

---

². Spread is the difference between the interest paid on US treasury bonds (which only pay a ‘risk-free’ rate because the US government has the highest possible credit rating) and the interest paid on all other debt securities, including asset-backed securities (the interest differential on these securities will reflect the extra amount of ‘risk premium’ that is added to the risk free rate). As can be seen in Figure 7, while the interest differential between ABS and government securities hovered in the region of 100–150 basis points for several years prior to 2004, that differential fell to about 50 basis points between 2004 and 2006, even though there was no radical change in the risk factors surrounding ABS at this time. The fall in the differential, therefore, must have been due to the pressure of demand for ABS: the greater that demand relative to the supply of ABS, the higher the price commanded by these securities and the lower the corresponding yield for investors.
Figure 4. (a) Holders of US Treasury Securities. (b) Holders of Corporate and Foreign Bonds. (c) Holders of Municipal Debt Securities

(Continued)
Unfortunately for these investors, the problem of yield continued to be an acute one.

It is here that we come to the subprime-backed securities. These can be classified as ‘second-floor’ securities (securities backed by securities) as opposed to ‘first-floor’ asset-backed securities (securities backed by bank loans) or ‘ground-floor’ securities (government and corporate bonds, the cash flows on which are serviced out of current incomes). The process by which these credit products were created is as follows (see Figure 8):
subprime loans were removed from the originating bank’s balance sheets and securitized through special purpose entities; the securities purchased from these entities by the investment banks were combined with other asset-backed securities to form collateral for yet other securities: the structured

Figure 7. United States: ABS Spread (in basis points)

finance Collateralized Debt Obligations. These securities were issued in different tranches ranging from the AAA-rated super senior tranche that carried the lowest risk down to the unrated equity tranche that carried all the residual risk. Securities could be issued that carried a higher credit rating than did the backing assets because of various credit enhancements including over-collateralization (the volume of backing assets held is greater than the volume of securities issued), subordination (interest payments on super senior and senior securities are made first and only then are holders of the mezzanine tranche securities paid, and so on in descending order) and insurance (the senior tranches were given insurance cover by a sponsoring bank, an insurance company or monoline insurer). Using these same credit enhancement techniques, any unsold mezzanine and equity tranches could be resecuritized into CDOs squared and any unsold tranches of these products could be resecuritized into CDOs cubed. Another way of augmenting existing CDO stocks was to use cash CDOs as reference entities for credit default swaps, thereby creating ‘synthetic’ CDOs.

By the end of 2006 there was an estimated US$ 3 trillion worth of cash and synthetic CDOs outstanding, approximately 95 per cent of which were of US origin, a ratio that was appreciably higher than the US’s share of 80 per cent for asset-backed securities, a ratio which was in its turn significantly higher than the US’s share of 50 per cent for ordinary debt securities. When explaining why so many CDOs had been created in the US, most commentators take it as read that their fundamental rationale was to disperse the risk attaching to subprime loans. In other words, the usual explanation runs
the story in the direction as illustrated by the arrows in Figure 8: eager to make commission, the mortgage brokers and banks were only too willing to extend subprime loans in the knowledge that the investment banks and credit rating agencies, also eager to make commission, would help them to disperse the risk on these loans through sophisticated financial engineering. The position here is completely different. Credit risk transfer may have been part of the function of CDOs, but the chief rationale behind their creation was so that they could serve as wealth containers of a particular return-risk vintage. Given the shortage of high-yielding investable securities available to investors, the US banks and their associates had to find a means of creating additional stocks and in order to do this quickly they had to increase the rate at which bank loans were given over and above the rate as governed by conventional lending criteria. The banks did not give subprime loans in order to earn commission; they certainly earned commission, but the major reason why they gave those loans was because they constituted the basic raw material from which multiple volumes of triple-A rated structured products could be created. It has been estimated that by the time the subprime crisis broke out in 2007, there were approximately 38,000 triple-A rated subprime-backed securities in existence as compared with a few dozen triple-A rated government and corporate securities (Blankfein, 2009).

The composition of CDO buyers gives strong confirmation that this reverse story is the more correct one. If the chief motivation behind the creation of the CDOs came from the banks themselves one would have expected the banking sector to have retained the majority part of these products while off-loading a relatively small proportion to investors. This was clearly not the case. As can be seen in Figure 9, in 2006 the banks held about 30 per cent of all CDOs, a ratio that was higher than the 20 per cent held by institutional asset managers but lower than the near 50 per cent held by hedge funds.

Figure 9. Buyers of CDOs 2006 (per cent)

![Figure 9. Buyers of CDOs 2006 (per cent)](image)

The rise in the hedge funds’ holdings of CDOs correlated with the very steep rise in the amounts of client assets placed under their management (see Figure 10): finding it increasingly difficult to find yield in the other securities markets, institutional investors poured increasing amounts of cash into the hedge funds which, also finding it increasingly difficult to generate yield by relying merely on their traditional trading strategies, channelled much of this cash into CDOs.

If the question is asked why the direct investments in CDOs made by institutional asset managers were not substantially greater than they were, the answer is liquidity. Pension and mutual funds and insurance companies need to be in liquid securities if they are to rebalance portfolios for whatever reason and CDOs are highly illiquid on account of their relatively complex structure. Thus while these institutions were ready to invest directly in CDOs on a limited scale, their preferred strategy was to invest in the hedge funds who could provide them with a relatively greater degree of liquidity. If the question then asked is how is it possible to square the reputation of hedge funds as short-term ‘buy and sell’ investors with the illiquid and hence difficult to sell CDOs, the answer is to be found in the composition of hedge funds’ CDO holdings. Contrary to popular opinion, the bulk of these holdings was not in the equity tranches but in the senior tranches. These triple-A rated securities served a double purpose for the hedge funds in that on the one hand they generated a higher return than did government securities while carrying the same credit rating, and on the other hand their high rating meant

that they could be used as collateral in credit transactions. Hedge funds are heavy borrowers and in order to reduce the costs of borrowing from their prime brokers they used the triple-A CDOs as collateral, while the prime brokers for their part had to accept these CDOs as collateral given that it was they themselves who helped to create these products in another of their many investment bank functions.

The role played by the hedge funds in encouraging the growth of CDOs provides the all-important clue that the root cause of the subprime crisis lay not in the banking sector so much as in the global economic system taken as a whole. If one key characteristic of this system is the huge expansion of securities stocks relative to world output, another is the huge expansion in the demand for securities relative to their supply. While the restructuring of the securities markets according to the commodity principle has been a necessary condition for their continued growth, this principle has also imposed a certain constraint on the rate of that growth. Because the overwhelming majority of the world’s debt securities were priced and traded according to a market standard, their pace of expansion simply could not keep up with the pace of demand. To close this widening gap the US banking sector increased the rate of supply not only of asset-backed securities but also of CDOs. When the opacity and complexity of these securities proved to be the critical factors that helped to trigger the liquidity–solvency cycle that spiralled out of control in late 2007 and 2008, the banks were heavily criticized for breaking all the established rules of commodity exchange. These criticisms completely miss the point, which is that had the banks stuck to those rules they could never have created securities with a sufficient wealth storage capacity to accommodate the build-up of global wealth. The only way that they could even attempt to do this was precisely by breaking the rules of commodity exchange. Of course the banks and their associates made a great deal of money in the process, but in the final analysis it was not greed or overconfidence or hubris on their part that led them to overstep the limits of the global commodity system, but the pressure of global demand that was pushing up against those limits. If the hedge funds were the principal conduit of this pressure, its principal source was the clients of the hedge funds. Institutional investors were one important group of clients, but an even more important group were the high net worth individuals.

**THE NECESSITY OF THE SUBPRIME CRISIS: THE GLOBAL CONCENTRATION OF WEALTH**

It is not difficult to bring global inequality into the story behind the subprime crisis: without toxic securities, there would have been no crisis; without subprime loans, there would have been no toxic securities; and without a continuous downward pressure on wages in the US, as in just about every other area of the world, there would have been no continuous rise in the household
demand for bank credit. The difficulty lies in giving causal primacy to global inequality. The magnitude of this difficulty can be gauged by the fact that while a minority of economists who have analysed the subprime crisis do attempt to give primacy to inequality, the majority tend to attribute its root cause to a wrong organization of finance rather than to a wrong distribution of income.

The failure to make a convincing case for the primacy of inequality is immediately apparent in the Marxian analyses of the crisis. The standard Marxian theory of capitalist crises is essentially this: the payment of wages at the value of the labour capacity is at once the primary source of profits and the source of constraints on their realization; these constraints can never be eliminated but they can be temporarily suspended by various means including the expansion of credit; when these means are finally exhausted and the constraints on profits again begin to tighten, the resulting cutbacks in capital investment and accompanying lay-offs trigger an economic crisis. Now the opening part of this sequence does accord reasonably well with what has been happening in the global economy: the share of wages in national incomes has been falling since the 1970s (Glyn, 2007; Stockhammer, 2009), a trend that has been reinforced by the massive influx of labour into the global labour pool following the collapse of the communist systems and the integration of China into the world market, and realization problems have accordingly become more pressing as attested by the chequered performance of profit rates in the core regions of the world capitalist system (see Brenner, 2006; Glyn, 2006) and by periodic crises in its peripheral regions.

By contrast, the latter part of the sequence does not accord so well with recent events. Although the realization constraints on profits were never eliminated, they continued to be eased to a sufficient extent to prevent them from being the catalyst triggering a global economic crisis. When this crisis did eventually break out, its origins lay not in the market for corporate debt or in the market for corporate equity, but in the market for mortgage-backed securities, that is to say, in that part of the financial sector that had the least connection with corporate profitability. Although a number of writers have tried to get round this peculiarity in their explanations of the global financial crisis by adding various supplementary stories to the orthodox Marxian theory of crisis, the fact that these explanations remain centrally focused on corporate profitability explains why they still command little support.

---

3. For a lucid summary of the different versions of the Marxian theory of crisis see Evans (2004).
4. For estimates of the size of this influx see IMF (2007).
5. Explanations for the financial crisis given from an orthodox Marxian standpoint can be found in Monthly Review, International Socialism and in a host of other left-wing periodicals. However, it should also be noted that not a single paper on the financial crisis written from this standpoint was included in the recent special issue of the Cambridge Journal of Economics devoted to the crisis (Blankenburg and Palma, 2009) even though it featured contributions written from just about every other heterodox perspective.
While the orthodox Marxian accounts of the subprime crisis focus on the constraints on profitability imposed by income inequality, other heterodox accounts of the crisis that similarly attempt to give centrality to this inequality tend to focus on the constraints imposed on macroeconomic growth. One typical line of argument runs as follows (see Stockhammer, 2009). The long-term trend declines in real wages on the one hand and in rates of investment on the other threatened to hold back countries’ domestic economic growth; while some countries in continental Europe and in Asia chose to boost growth through an export-based strategy, other countries, notably the USA, chose to achieve the same goal through a credit-based strategy. These two strategies were mutually complementary in that substantial proportions of the surpluses generated by the exporting countries were recycled to the importing countries. However, while the inflows of surplus funds into the US helped to finance that country’s deficits, their downside was that they also helped to fuel a property price and bank lending boom that was bound to collapse at some point or other. This argument is fine as far as it goes, but the problem is that it does not go far enough. To explain the US subprime crisis it is not enough to explain how the US banks came to possess the financial means of expanding the supply of bank loans to large swathes of the US household sector. What must also be explained is what motivated the banks to securitize these loans and then to resecuritize asset-backed securities into structured finance CDOs. It is interesting to note that while some authors simply ignore this analytical gap and are content to talk of the general link between inequality and the financial crisis without going into the specific details of the subprime-backed securities, other authors are conscious of this gap but then fill it by adding to the story of income inequality a supplementary story of bank culpability.6

The drawback which is common to the Marxian and other heterodox accounts of the crisis is that inequality is looked at solely from the point of view of the dispersion of incomes across groups of individuals when what should also be looked at is the concentration of wealth ownership in the hands of particular individuals. This one-dimensional approach to inequality is due to the nature of the problematic that has traditionally preoccupied economists: if the key question is how inequality affects the rate of profit or the rate of macroeconomic growth then it is entirely correct to concentrate attention on the relation between the different levels of income earned by different groups of individuals. However, if the key question is how inequality impacts on the rate of supply of securities — that is, on the rate of supply of the financial claims on underlying output and income streams — then it is the relation

6. This is why Fernandez et al. (2008), for example, found it necessary to present their account of the role played by income inequality in the subprime crisis in a Minskyan framework. Meanwhile, other authors who have also used this same framework to explain the crisis have not been bound by the reverse obligation. Thus Kregel (2008) barely mentions income inequality in his Minskyan analysis of the build-up to the subprime crisis.
between the accumulating stocks of personal wealth and the availability of wealth containers that should be the focus of attention. This latter question has never before been placed on the agenda because in no previous period in history has the growth and concentration of personal wealth reached such global proportions as to seriously pose a problem of a shortage of investable securities. Before elaborating on this point, let us first look at some of the statistics regarding the concentration of wealth ownership (see Figure 11).

Between 2000 and 2007, the number of high net worth individuals (HNWIs — those with net assets in excess of US$ 1 million) rose from approximately 7.5 million to more than 9.5 million (a figure that represents just over 0.01 per cent of the world’s population) while HNWI assets rose from about US$ 25 trillion to an estimated US$ 40 trillion.
Photis Lysandrou

(see Figure 11a). However, even these figures understate the true degree of wealth concentration because more than a third of all HNWI wealth is held by what are classified as ‘ultra’ HNWIs (those with net assets in excess of US$ 30 million) who numbered just over 100,000 in 2007 (see Figure 11b). This concentration of wealth is truly global in the sense that it not only transcends differences in geographical location or in social and cultural background but also differences in occupation or function; thus the ranks of the world’s super rich include not only financiers, industrialists, retailers or traders but also individuals drawn from the worlds of media and publishing, sport and entertainment and so on. Although these observations clearly undermine those Marxian theories that identify ‘class’ relations as the locus of exploitation, they are on the contrary entirely in keeping with that version of the theory that identifies ‘commodity’ relations as the locus. Marx begins his major investigation into capitalism with an analysis of the commodity because he is aware that with the emergence of this new type of social system all personal relations of exploitation begin to be dissolved into the impersonal relations of commodity exchange: while the differences between capitalists and workers in terms of their respective position and power are necessary to the extraction of a surplus, the sufficient condition for this extraction lies in the pricing of their different functional capacities against market standards (Lysandrou, 1996, 2000). From Marx’s day down to our own, the commodity principle has been stretched to the point where it now encompasses virtually the entire globe with the result that virtually all local relations of exploitation have been dissolved into the exchange relations of the global market. There now exists a dense matrix of globally interlocking commodity relations and almost all individuals on the planet occupy a position somewhere in that matrix. The vast majority do so merely as possessors of a capacity for labour and end up putting far more into the global commodity matrix than they take out, while a tiny minority of individuals can take out far more than they put in because they occupy a different position as owners of other capacities or of various claims on capacities.

If the global stretching of commodity relations is one factor behind the unprecedented global concentration of wealth, another and even more important factor is the global deepening of these relations to include equity and debt securities. Recall that, while still comparatively small in 1980, the stocks of these tradable financial claims have since grown at such a rate that they now completely dominate the material output base on which they rest. This growth in securities stocks is the more important driver behind wealth concentration because although the incomes of many HNWIs may originate in the performance of a particular economic or social function or in the ownership and control of certain non-financial assets, it is through the subsequent diversion of major portions of these incomes into securities that the HNWIs can continue to build up their wealth. As shown in Figure 12, which depicts the breakdown of HNWI asset holdings between 2002 and 2007, the bulk of these holdings were in securities, including debt securities.
Over this period, HNWIs’ bond holdings averaged US$ 8 trillion which is a substantial sum; indeed so substantial that there can really be no argument, however formulated or presented, that can justify a situation where about 0.01 per cent of the world’s population can hold about 10 per cent of the financial claims on the world’s governments and large corporations.

Leaving aside ethical considerations, the material implications of global inequality and wealth concentration are also extremely serious in that it was this concentration that helped to drive the growth of the toxic securities which were at the epicentre of the global financial crisis. Apart from the banks, the only other organizations buying CDOs in any substantial volume were the institutional asset managers and the hedge funds and in both cases their reasons for doing so can be traced back to the world’s high net worth individuals. Take the institutional investors. Given the relatively small size of most of the world’s bond markets, these investors had to concentrate most of their bond holdings in the US where they faced increasing competition from other investors, including wealthy individuals. By occupying substantial space in the US municipal and corporate bond markets, the US and foreign HNWIs in effect helped to block all the exits available to institutional investors on the ground floor thus forcing them to move upstairs into the asset-backed securities and then into CDOs in the quest for yield.

Now take the hedge funds. Since liquidity concerns prevented the pension and mutual funds from investing heavily in CDOs, they had to turn to the hedge funds to satisfy their demand for yield. It is just conceivable that had institutional investors been the only clients of the hedge funds, the latter could have solved the yield problem simply by relying on their traditional investment and trading strategies. The truth was that the hedge funds did have other clients, chief amongst whom were rich individuals (see Figure 13) who also continued to provide the hedge funds with large sums of money in
their quest for yield. By continuing to occupy substantial space in the hedge funds’ client base, the HNWIs in effect helped to block any possibility that the hedge funds could resolve the yield problem without substantial recourse to CDOs. The upshot of the above is that, had private wealth been more evenly dispersed in the global economy, the pressures on the banking sector emanating via asset managers and the hedge funds to artificially boost securities stocks would have eased enough so as not to force it into creating the toxic securities on the scale that it did and its collapse would not have occurred when it did. In short, it was the fact that wealth concentration had gone a step too far that ultimately explains why the banks overstepped the limits of the global commodity system, thus precipitating its crisis.

POLICY IMPLICATIONS

A major policy implication that follows from the above analysis is that the world’s wealth has to be more equitably distributed if global financial crises are to be avoided. To give importance to this policy is not to exclude the many other proposals that have been suggested for making the banking sector and entire financial system more transparent, more efficient and, above all, more accountable. On their own, however, these proposals are insufficient. No matter how radically the financial system is reformed or re-structured, as long as there remain external pressures on it to create products or to indulge in practices that are harmful to it, such products and practices will continue to be introduced and financial crises will continue to occur. These external pressures will only be removed when there is a significant

Figure 13. Source of Hedge Fund Capital by Share of Assets under Management

re-distribution of wealth. This should begin with a three-point tax action plan:

1. tax havens need to be closed down to prevent tax avoidance;
2. tax structures need to be harmonized to prevent any exploitation of differences between them;
3. tax rates need to be re-aligned so that the tax burden is again distributed on a progressive rather than regressive basis.

Action on taxes is vital not only because this can help to prevent future crises, but also because it can help finance the resolution to the present crisis. Forced into bailing out the banks through various means including nationalization and the purchasing of the toxic assets that they hold, and at the same time desperate to prevent the current recession from turning into a 1930s-style depression, the world’s governments have been pumping money into their domestic economies at a high rate. This means that the supply of government bonds, which until now have constituted about a quarter of all debt securities, is set to expand to even higher levels, bringing a corresponding expansion in the debt service burden. Governments may pile up more and more claims on their future revenues, but the more that they pile up the lower will be their credit ratings and the higher will be the risk-adjusted returns that they will have to give to investors. Where are these returns to come from? Since there are limits to how much can be raised from low- to middle-income households, small businesses and other immobile taxable units, there will have to be — in the absence of serious tax reforms — deep cuts in key areas of government expenditure, including those of health, education and other social provision. This is precisely what we have been seeing right across the European Union, not only in the poorer member states such as in Greece and Ireland but also in the wealthier states such as the UK and France.

To get the necessary tax reforms implemented will not be easy for two interrelated reasons that centre on the question of coordination. On the one hand, wealthy individuals, together with international banks and multinational corporations, continue to exercise huge pressure on national governments not to restructure taxes because all of them can hold up the threat of exit and relocation to an alternative tax jurisdiction. On the other hand, many governments are themselves reluctant to coordinate tax systems partly on ideological grounds (this is particularly the case in the advanced market economies where the idea that tax competition equates with ‘tax efficiency’ is prevalent) and partly on material grounds (desperate to attract and keep foreign investment funds, many of the world’s poorer countries compete with each other in providing foreign private and institutional investors with generous tax privileges). All of this said, however, national governments can be made to take coordinated action to restructure and harmonize tax regimes providing strong countervailing pressure
is brought to bear on them, and for this to happen all that is required is that the world’s progressive forces give the same overriding priority to tax regime change that the world’s rich give to opposing any such change.

CONCLUSION

Marx was right. Exploitation and wealth inequality are the usual causes of crisis in a commodity producing system, and these same factors have also been directly responsible for the current global crisis. Where he was wrong was to assume that capitalist crises could only occur in GDP space. However, Marx had to make this assumption because at the time that he was writing the capital markets had not yet matured to the point where they constitute a second commodity space. Today they have and, as a result, a different crisis transmission mechanism has come into effect: prevented from finding expression below, in an excess supply of products in GDP space — because the demand for these has been propped up by a number of supports that include increased public spending on the one hand and increased credit to the private sector on the other — the accumulation of surplus pools of wealth has instead found expression above, in an excess demand for securities in capital market space.

The fact that the global capitalist system has the potential for generating crises on an equally global scale does not mean that this potential has to be realized. This is so only if the system’s capacity for generating wealth inequality remains unchecked. As things stand, we are at a crossroads. If financial disasters do not kill this planet, other disasters, all which link in some way or other to poverty and desperation, certainly will. It is therefore imperative that the financial system be brought under democratic control and restructured so that it benefits the world’s majority rather than its minority. Socialization of ownership of the means of production has always been a key demand of the progressive forces in society. In light of recent structural changes in the capitalist world economy, this demand might be amended to one that calls for the socialization of ownership of the financial claims on the means of production. A globally coordinated system of wealth taxation would be a first crucial step in this direction.

REFERENCES

Global Inequality and the Subprime Crisis

Blankfein, Lloyd C. (2009) Remarks to the Council of Institutional Investors, 6 April, Washington, DC.


