Article

ELRR

The Economic and
Labour Relations Review
2018, Vol. 29(4) 394–409
© The Author(s) 2018
Article reuse guidelines:
sagepub.com/journals-permissions
DOI: 10.1177/1035304618810974
journals.sagepub.com/home/elrr

Paved with good intentions: Misdirected idealism in the lead-up to 2008's GFC

Anthony M Gould and Milène R Lokrou
Laval University, Canada

Abstract
Irresponsible lending practices on the part of financial institutions and proliferation of tradable derivatives were key causal agents of the 2008 financial crisis. However, it is less clear why, historically, loose credit arrangements were so widespread. Somewhat misleadingly, much conjecture has laid blame at the feet of financial institutions themselves. While it is true that duplicitous and even corrupt lending practices were consequential antecedents of the crisis, a legacy commitment to certain – laudable – elements of New-Dealism created context for these elements to become established. To understand really what went wrong, it is necessary to look back before the 2000s and appreciate the interaction that was occurring between a long-term policy commitment to neoliberalism and piecemeal/fragmented application of approaches that aimed to assist financially disadvantaged people. Using the analogy of heart-attack pathology to guide some of its analysis, this essay argues for better policy-integration.

JEL Codes: G01, G2, F66, H12, J52

Keywords
Business cycle, collective bargaining, economic stimulus, employment conditions, global financial crisis, globalisation, industrial relations, Keynesian economics/theory, labour markets

Introduction

The proximal and semi-proximal causes of the 2008 global financial crisis have been well analysed (Acharya and Richardson, 2009; Booth et al., 2009; Boyer, 2009; Crotty, 2008). Its distal causes less so. This is not surprising and typically the case with post-mortems on

Corresponding author:
Anthony M Gould, Faculty of Social Sciences, Laval University, Sainte-Foy, Quebec City, QC G1V0A6, Canada.
Email: Anthony.Gould@rlt.ualval.ca

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

unanticipated calamities. The fact is, the further one goes back in time before a crisis incident, the more obscure putative causal agents seem to be and the more tenuous their connection with acute trigger-events. Indeed, long-term causal elements are inevitably hard to spot and may even be entirely off the analytic radar screen (Lokrou and Gould, 2014). However, as a matter of epistemology, to understand the anatomy of crises – be they economic or of any other kind – a comprehension of context is invariably the key challenge. Lest we be accused of over-reliance on reasoning by analogy and the attendant problems that come therewith (e.g. Genter, 1983), we contend that the example of a heart attack serves to well illustrate why distal elements are often more consequential than those that are temporally closer and appear as salient. Specifically, healthy hearts are robust. They withstand vigorous exercise. However, in cases where atherosclerosis partially occludes a coronary artery, hearts do not fare so well. In such situations, when demand for blood by the aorta increases in response to (say) physical exertion, a restriction (or partial occlusion) may become total as lipid-based compounds in the form of glycerides and triglycerides break-off under the strain of rising blood pressure. At this point, there is – or could be – complete occlusion, a blockage. At the moment when the heart most needs blood, it is either depleted of it (angina pectoris) or completely deprived of it (myocardial infarction). This is the standard pathology of a heart attack (Basso et al., 2001; Kemp and Conte, 2012). In analysing how such a medical event occurs – or, more precisely, asking what causes a heart attack – it is patently taking the easy, and somewhat naive, path to say ‘over-exertion’. Indeed, pushing the physical limits would have been fine if contextual elements were as they should have been. As such – and as a cursory glance at cardiology journals reveals – in the case of heart attacks, researchers focus the bulk of their analytic attention on elements that are present years before the occurrence itself (Krieger, 2008). There is a lesson here for those concerned with public policy.

In this article, we propose that an obscure interaction between two sets of incongruous variables created much of the context for the 2008 global financial crisis. We argue that the comingling of these variable-sets is what is important. In other words, put in terms of Boolean logic, the crisis would not have occurred if only one of each array had been present. The first set concerns a post-industrial public-policy emphasis in Organisation for Economic Co-operation and Development (OECD) countries on neoliberalism. Here, neoliberalism is shorthand for an approach to governance that promotes the market solution as the default way of solving social and economic problems and a concomitant marginalisation of the State and regulatory oversight (Braedley and Luxton, 2010; Fairbrother and Rainnie, 2006; Tickell and Peck, 2003). The second set of variables is antithetical and is about a lingering and merely intermittent legacy-commitment to key laudable priorities of the New-Deal era. Four sub-elements are relevant here. First, there is the Carter Administration’s 1977 Community Reinvestment Act and its various subsequent amendments (Demyanyk and Van Hemert, 2009). Second, there is the Bush Administration’s 2003 push for tighter scrutiny of housing loan financing arrangements which was opposed by the Democrats on the ground that it might unduly disadvantage poor people who were being frozen out of home ownership (Strickland, 2004). Third, there is a peculiar issue with interest rates that proved to be more nuanced than dismissive analyses that merely flag the problem of general repayment difficulties that ensue when rates rise (Schularick and Taylor, 2012). Fourth, there is repeal of the Glass-Stegall

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

Act (Crawford, 2011) that is, not so much a legacy element, but rather – to stick with the medical/biological analogy – something of a catalyst, an agent that facilitates a chemical reaction without taking part in it.

In the remainder of this essay, we prosecute our case. Our argument is summed-up with a single proposition: neoliberalism in circumstance of haphazard/intermittent concern about poor/low-income people creates a potent cocktail for bringing about a 2008-style financial crisis. The article has four sections. First, there is a brief survey of some of the better-known proximal causes of the crisis. Second, there is an overview of neoliberalism, where the philosophy is placed in its historical context and emphasis given to its punitive impacts on those who are not well off. As part of the treatment of this subject matter, theory about neoliberalism will be briefly evaluated in light of various evidence/data. Third, there is an analysis of how four legacy-elements of new-Dealism – intended mostly to redress wealth inequality and facilitate access to key services by the economically disadvantaged – was nested in an overall neoliberal agenda that was being implemented in OECD countries. Fourth, in the conclusion, the case is made that broad commitment to the neoliberal project in combination with merely piecemeal allegiance to legacy-elements of New-Dealism created an ideal firmament for the proximal elements – the more salient causes – of the crisis to combine to produce the event.

The crisis: Proximal causes

The 2008 global financial crisis commenced acutely in the United States (Bordo and Landon-Lane, 2010; Boyer, 2009; Davis, 2011). There is widespread consensus about its more consequential proximal causes. For example, the housing and credit bubbles that were forming in certain American cities in the preceding years were key trigger events (Acharya and Richardson, 2009: 196; Crotty, 2008). In and of themselves, economic bubbles are not inherently negative in the long-term but rather an inevitable feature of the boom-bust cycle (Crotty, 2008). However, the pre-2008 bubbles arose from a confluence of atypical elements. These included an absence of appropriate oversight and prudential supervision by regulators, improvidence and lack of planning on the part of stakeholders in the financial services and real-estate sectors and, in certain cases, corrupt and duplicitous business practices by the same parties (Gould, 2014; Lokrou and Gould, 2014).

As late 2008 approached, distal influences on the – soon to be – financial crisis were firmly cemented in place and provided context for the more well-known direct trigger events to play out. There was unprecedented housing debt in the US that had found its way, in the form of derivatives, on to the balance sheets of financial institutions throughout the world. A derivative was a newly developed type of contract made between a mortgage holder and a third party. It took the form of a secondary bet placed on an aspect of market performance. Derivatives may be used to create disconnect between a primary price fluctuation and the benefit a third party derives from such a change. For example, according to how a deal is structured, the holder of a derivative could make a substantial gain (or loss) from a small rise (or drop) in the price of the element against which their wager is pegged. In the case of the pre-2008 US sub-prime market, two classes of derivative, credit-default swaps (CDS), and collateralised debt obligations (CDO)[1] had special import (Boyer, 2009). A CDS is a bet that lending institutions allowed to be made against

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

the probability of mortgage default (Boyer, 2009; Gould and Lokrou, 2012). The third party could make payments in exchange for speculating that bundled loans would – or would not – be able to be repaid. In accepting such a contract, the third party was acquiring an asset that often had a ledger value many times higher than the worth of the re-bundled mortgages from which it was derived. Credit rating agencies had mostly over-valued subprime-derived securities.[2] Hence, when under-capitalised housing investors were not able to repay debt and found themselves in negative equity positions, mortgage-backed securities (derivatives) changed from being assets that were often many times larger than the value of the original housing loan to being liabilities of equivalent magnitude. Indeed, major insurance and merchant banking institutions which had invested heavily in derivatives such as Lehman Brothers (LB) and American International Group (AIG) were rendered insolvent due to housing loan default (Boyer, 2009). However, just prior to the crisis these institutions had balance sheets portraying their worth as many tens of billions of dollars.

As an immediate consequence of widespread mortgage default, the American real estate bubble burst in September 2008. In this context, a burst bubble is intended to evoke an image of the valuations of securities tied to property in the US dropping precipitously. This devaluation was unprecedented in modern times and had three immediate global recession-inducing consequences (Gould, 2014). First, there was reduced credit availability to both consumers and businesses. Second, there was a crisis of consumer confidence over bank liquidity and solvency. Third, banks stopped – or substantially reduced – lending to each other. These impacts induced losses on stock exchanges throughout the world; specifically through their influence on securities held by European investment banking firms and, more generally, through their effects on the confidence of consumers outside of North America. While such events were unfolding, real estate prices in the United States plummeted unprecedentedly such that, by October 2008, 20% of American properties were in negative-equity positions (the mortgage owing on them was in access of their market value) (Haughwout and Okah, 2009). Between June 2006 and June 2009, median US house prices fell by approximately 30% (Case and Quigley, 2008). This diminished aggregate household wealth by roughly seven trillion dollars (Mishel et al., 2012).[3] In an effort to limit damage, Western governments reacted with remedial measures. These were initially more stimulatory than austerity-related. For example, in the United States, the newly elected Obama administration employed pump-priming and prop-up strategies following the collapse of merchant bankers LB and the takeover of Merrill Lynch (ML) by the Bank of America (BofA). The US Federal Government invested 85 billion dollars to ensure that merchant bank AIG stayed viable. Overall, the Federal Reserve sponsored stimulatory initiatives to ensure that the shadow-banking sector remained solvent with high-profile payments of 653 billion dollars to key institutions on 12 November 2008 and another 904 billion on 14 January 2009 (Boyer, 2009). Although it originated in the United States, the crisis rapidly became international in its scale and impacts. For example, towards the end of the year, the European Union Commission recommended a 200 billion euro stimulus package (about 1.5% of the aggregate gross domestic product (GDP) of the countries being targeted). This initiative was ratified in December.

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

In 2010, the G20 (Group of 20) summit held in Toronto marked the beginning of the new global financial policy orientation of governments struggling to manage the aftermath of the crisis (LoDuca and Stracca, 2014). The plan devised in Toronto was to reduce public debt within G20 nations by 50% by 2013 (LeQueux and Peetz, 2013). It seemed that, at least in one sense, the bailouts had created another set of problems. Specifically, large unanticipated government outlays were now threatening the solvency and credit ratings of sovereign countries and the most palpable remedy was to be stringency, mostly manifested in the form of cuts to government services.

Neoliberalism: A break with New-Dealism

Almost four decades prior to the 2008 global financial crisis, at about the time of the Nixon Administration, the post-war economic long-boom was abating. The New-Dealist prescription seemed to be struggling to continue to deliver rising and broadly shared prosperity. From 1973 to 1975, in the worst economic slump since the great depression, industrial output fell by 10% and the US GDP dropped by 1% (Issawi, 1979; Kolm, 1977: 815). Also during this period, the world's 25 richest countries saw their economic growth rate fall from 5% to 0% (Issawi, 1979; Kolm, 1977: 815). To add to the malaise, inflation was rising sharply during the era. However, perhaps to the casual observer, it was the 1973 Organisation of the Petroleum Exporting Countries (OPEC) crisis that seemed to herald the beginning of a new epoch. The OPEC crisis saw Middle-Eastern oil-producing nations acting in concert to quadruple the price they were charging for their product to client countries. Although much contemporaneous literature portrayed the conniving Arab Gulf State countries as setting the wheels in motion for the epoch's incrementally increasing gloomy economic outcomes (eg Issawi, 1979), in fact from as early as the 1960s more systemic elements were undermining prosperity. Return on capital deployed in Western industries was falling from around this time (Moody, 2007). Specifically, from approximately the early 1960s, international competition was encroaching on domestic market share. In economic terms, Western industries were transitioning from comparatively inefficient Fordist-era structures of monopolistic competition in which cost-plus forms the basis of pricing towards configurations of perfect competition where output settles at a point where marginal cost equals marginal revenue for any particular firm. For practical purposes, super-normal investment return was regressing towards an international mean. In lay terms, Western capital was having to work harder from the 1970s. The rise of Japan in the 1950s and the Asia Tiger economies in the 1960s was reducing the rate at which surpluses could grow in the US and the productive inefficiencies associated with New-Dealism that had been subsidising the lifestyles of ordinary people were now looking like an unaffordable luxury.

At about the time of the OPEC crisis and the ensuing precipitous decline in wages that occurred as increasingly managerialist-orientated employers insisted on progressively growing profits at any cost (Moody, 2007) a marginal strain of thought was becoming mainstream. Worsening economic circumstances made a fresh approach seem indispensable. Austrian-school theorists such as Friedrich Hayek and later his devotees, the anti-Keynesian/Monetarist Milton Friedman and James Buchanan, who championed public

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

choice theory, were standing-by with a new proposal. Their prescription would, according to some, herald return to the common sense of the enlightenment as exemplified in the ideas of 18th- and 19th-century thinkers such as Jean Baptiste Say, John Locke, David Hume and Alexander de Toqueville (Combe, 1996). However, others interpret neoliberalism as something other than merely old wine in a new bottle and view as spin doctoring its purported lofty intellectual pedigree (Combe, 1996). When originally articulated in the 1970s, the new blueprint embodied two key, and related, tenets. First, government and governance are malignant influences or at least overly intrusive. Second, laissez-faire capitalism remedies economic and – more particularly – social problems. Commencing with Augusto Pinochet`s 'Chicago-boys' period of military dictatorship – but quickly extended to the United States and Great Britain in particular – it was soon to be the dawn of the era of the ubiquitous application of the market solution as a universal panacea.

According to the neoliberal worldview, there are four related domains where notions of commercialisation, corporatisation, and privatisation were underutilised as public policy solutions during the New-Deal era. First, private sector entities should be more freely able to compete to provide services that have hitherto been, as a matter of orthodoxy, the preserve of the public sector (Combe, 1996). There is a somewhat concealed agenda here; if someone wants something, indeed needs it, they should pay for it. The fact that they may not be able to is an ephemeral impediment and represents a moral failure in that the needy person has not managed their life responsibly (Combe, 1996). Second, with a little ingenuity, social problems such as violent crime, teen pregnancies, suicide, divorce and the like can be viewed through the prism of supply and demand and thus reconceptualised as solvable using the market solution (Combe, 1996). Relatedly, policy makers should be imaginative in their quest to create sunrise industries. They should proactively conceive of new functions and speculate about how privately managed entities could carry them out for profit. For example, as Connell (2010) points out, it is only in the last 35 years that in the Western World, there has arisen the notion of supply and demand for drinking water, body parts and outer space (Connell, 2010). Third, Joseph Schumpeter's conception of industry creative destruction has no consequential shortcomings. Indeed, it is even beneficial for those who lose their job when an economic sector becomes redundant. The rationale here is that laid-off employees face new opportunities, for example, perhaps the chance to obtain a more interesting job in an emerging industry. Fourth, labour markets should be deregulated. Underlying this prescription is the axiom that there is less difference between labour markets and other kinds of markets than was thought to be the case. This aspect of the neoliberal agenda mostly boils down to an assault on the legitimacy of, and institutions supporting, organised labour. Neoliberal ideologues consider that unions create competitive distortions through pushing wages beyond their market value and hindering labour flexibility.

Neoliberalism inevitably comes with the promise of reduced taxes. In the Western world, this became especially salient in 1978 when California passed Proposition 13, a referendum to cap property tax. According to Chapman (1998), this legislation heralded the emergence of a new policy direction for the West. However, in reflecting on changing taxation regimes over the last 40 years, Campbell (2012) argues that, although in the US

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

and other OECD countries, conservative and liberal administrations committed to the neoliberal agenda have often vied to outdo each other in the tax-cutting stakes, government receipts have mostly remained about the same as a proportion of GDP. Rather, in most Western countries – often under the guise of user-pay – there has been a shift to regressive tax regimes. Such systems, by definition, discriminate against low-income earners (Campbell, 2012).

The promise of better capital allocation and ensuing efficiency dividends that accompany neoliberal theory have not well translated into benefits for ordinary people, particularly those living in the West. Indeed, even before factoring – in the impacts of the 2008 crisis, neoliberalism was failing the majority of those in OECD countries. However, prior to the crisis, proponents of rational expectations and efficient markets theory were still in their intellectual ascendancy. They could point to some upside of broad commitment to the market solution as a generic magic bullet. The problem was that such benefits were not especially relevant to the lower and middle classes. For example, in the early 2000s, the free-marketeers typically interpreted the 'great moderation' of the business cycle as evidence of a policy triumph (Coibion and Gorodnichenko, 2011). The post-industrial attenuated boom-bust oscillation seemed to be driven by certain of neoliberalism's fringe elements. These included increased central bank independence, application of the 'Taylor Rule'[4] in monetary policy and greater within-sector adaptability including 'just-in-time' inventory management but, more particularly, flexible labour use strategies supported by legislative programmes that had whittled away employee rights and protections. However, the lingering question was what was being traded-off for the smoothed-out boom-bust cycle?

In a wide-ranging survey of the impacts of the West's post-Keynesian public policy emphasis, Weisbrot and Ray (2011) focused on economic indicators as well as social/psychological measures within low- and middle-income countries to compare the period 1960–1980 with 1980–2005. Neoliberal champions had argued that these nations would be first in-line to receive the advantages of the new approach (Putnam, 2001). However, Weisbrot and Ray (2011) concluded that, far from them being the beneficiaries of neoliberalism, they had in fact declined, particularly on key financial indices. Within the United States – a country that was always going to be at risk of setback when measured in narrow economic terms – it is conspicuous that even social justice indicators have it in 2015 at number 25 out of 31 OECD countries, just above Turkey, Greece and Chile (Kauder and Potrafke, 2015). When further unpackaged, this result glosses over the fact that the new social and economic order has been especially difficult for some sectors of the population. For example, researchers such as Case and Coates (2017), and Case and Deaton (2017) have been tracking the aggregate fate of middle-aged white Americans (particularly white American males) without college degrees since 1999. They note that the mean mortality-rate for this cohort was declining steadily throughout the 20th century, but in the 21st century began to rise precipitously. According to the authors, the trend reversal is largely attributable to psychological factors including depression and anxiety leading to suicide and drug overdose. In developing this thesis, they propose that lost status arising principally from job insecurity and career disruption in the age of neoliberalism are consequential antecedents of such disquieting contemporary phenomena. Research of this kind is eye opening. It reveals a weakness in neoliberal theory that

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

proponents of the approach find difficult to bat away. This matter is dealt with in depth by Wilkinson and Pickett's (2010) book, *The Spirit-Level: Why Inequality Matters*. These authors provide data indicating that an across the board rise in levels of prosperity will have adverse aggregate psychological impacts if it creates a concomitant growth in income inequality. However, insofar as neoliberalism is concerned, the problem is somewhat different from what happens when the wealth-gap widens. In fact, at odds with what neoliberal theorists originally assured would happen, the new approach has not even provided overall rising prosperity, even differentially rising prosperity. On the contrary. For example, in 2000, once again before the 2008 crisis, Crotty (2000) declared neoliberalism to have failed to live up to expectations. He summarised his dismal perspective on the matter, thus …

> The evidence to date supports neoliberalism`s critics. The promised benefits of neoliberalism have yet to materialise. Global income growth has slowed as has the rate of global capital accumulation, at least for the majority of the world`s people. Productivity growth has deteriorated, real wage growth has declined, inequality has risen in most Western countries, real interest rates are higher, financial crises erupt with increasing regularity, the less developed nations outside East-Asia have fallen even further behind the more advanced and average unemployment has risen. (p. 10)

Some remnants of New-Dealism nested in the neoliberal agenda

It will be argued here that poor regulatory oversight and public policy failure – mostly on the part of well-intentioned Democratic-Party administrations – created, in combination with an overall agenda of neoliberalism, consequential antecedents of the 2008 crisis. As noted, scholars have made much of the role-played by sub-prime and adjustable-rate mortgages in the pre-crisis years (e.g. Boyer, 2009; Tarr, 2010). When analysed retrospectively, the issuance of loans to those with poor credit histories appears as an unambiguous influence on rising real-estate prices and a subsequent over-supply of properties (eg Crotty, 2008). However, prior to the crisis, such salience was less obvious. Indeed, in the 1990s and early 2000s, for example, there was widespread and genuine failure to appreciate the roles played by investment banks and hedge funds, the so-called shadow banking industry, in providing credit to the American economy. The contextual elements creating irresponsible financing arrangements were mostly well intentioned but did not suit their broader neoliberal circumstances. Here, four of these will be presented and interpreted as dysfunctional legacy elements of the New-Deal era. The goal is to prosecute the case that public policy failure – in the form of an overall agenda of neoliberalism combined with a half-hearted commitment to certain more Keynesian-style elements – created the most important pre-conditions for the eventual implosion.[5] These four key legacy elements – argued here to be consequential – are as follows: the Community Reinvestment Act (CRA) (1977) and its subsequent application and amendments; the Federal Department of Housing and Urban Development`s (HUD) pressuring of government chartered corporations to purchase (or securitise) subprime loans in 1992; the US Federal Reserve's orientation towards prudential supervision and monetary policy in the years between 2001 and 2006; and, the 1999 overturn of the Glass-Steagall Act from 1933 (Wilmarth, 2002). As

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

noted, repeal of Glass-Steagall was not so much a New-Dealist legacy element as it was a catalyst for other dysfunctional factors to combine synergistically.

The passing of the Community Reinvestment Act is the first, and most temporally distal, legacy element of consequence in the lead-up to the financial crisis of late-2008. At the behest of the newly elected Carter Administration acting under pressure from community welfare groups including the Association of Community Organisations for Reform Now (ACORN) and the Southern Poverty Law Centre (SPLC), the US Congress passed the CRA (1977). Because of the revised policy direction, henceforth, banks and financial institutions were required to offer credit without discrimination to all sectors of communities they served. The intent here was to ensure that less-wealthy people could not easily be denied a loan or redlined, to use the Act`s vernacular. The new law limited the redlining of fledgling and small businesses seeking commercial finance and, in particular, aspiring first homeowners. At that time, the conservative banking community was uneasy about loosened credit availability but was forced to acquiesce under threat that they would be denied government approval to undertake merger and acquisition activity (Getter, 2015; Holmes and Horvitz, 1994; Kroszner, 2008; Park and Gould, 2017). In 1995, the Clinton Administration, through its HUD, placed additional pressure on banks to provide credit to low income earners. During this period, new lenders like Countrywide entered the financial services sector with plans to compete in ways that had been regarded as reckless throughout the 20th century. For the first time in modern banking history, the widespread practice emerged of not adequately using savings deposits to mitigate loan risks. This strategy put some – particularly the fledgling – lending institutions on the path of insufficient capitalisation. To support issuance of loans to less affluent people, the government`s new sub-prime authorisation provided for a, so-called, second-tier form of mortgage application that did not meet conventional standards of creditworthiness (Getter, 2015; Strickland, 2004). The notion of relying on statute law to force issuance of credit was a radical departure from orthodoxy. Subprime loans often provided 100% financing and did not take account of credit scores. They were frequently made without documenting income.

In historical accounts of the global financial crisis, it is sometimes overlooked that, in 2003, the Bush Administration pushed for the most wide-ranging review of housing loan financing arrangements since the savings and loans crisis that had occurred a decade earlier. Of course, there had been some securitisation of risky mortgages in the 1990s when firms like Bear Stearns, a wholly private entity, had begun underwriting debt. However, by the time of the Bush Administration`s proposed review, irresponsible financing arrangements were omnipresent. Perhaps even more disquietingly, the major sub-prime lenders were government-chartered entities: Fanny Mae and Freddie Mac (Simkovic, 2013). The overhaul plan – which the Democrat-controlled Congress opposed and defeated – was to regulate more intensively these institutions through creation of an independent agency administered by the Justice Department (Strickland, 2004). Those arguing for beefed-up external control and financing restrictions argued that if American taxpayers were to underwrite mortgages then public sector stewards should be able to assure them that their liabilities are adequately capitalised. The Democrats *voted against* tighter scrutiny including Securities and Exchange Commission (SEC) reporting.[6] Apparently, they considered that *more restrictive lending practices would unduly*

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

disadvantage poor people. In something of an unholy alliance, executives at lending institutions had – by now – mostly changed their stance on the issuance of risky loans and supported the Democrats. However, it was not concern for the poor that was motivating the bankers. Rather, it was the fact that their bonuses were now typically structured so that their remuneration increased when they reeled-in borrowers. As predicted by agency theory, they became less concerned about the solvency of their employing entity but focused instead on maximising their commissions, pegged in one form or another to how much they were able to lend (Essenburg, 2014).

The second legacy influence on the 2008 financial crisis occurred in 1992 when the HUD compelled Freddie and Fannie to purchase (or securitise) sub-prime loans. There were two – somewhat contradictory – reasons why the Secretary, Democrat Andrew Cuomo, intervened in this way. First, he argued that it was prudent to diversify the risk associated with mortgage default. Second, he sought to make more credit available to the poor and disadvantaged (Gould, 2014). In keeping with these priorities, Congress passed the Federal Houses Enterprises Financial Safety and Soundness Act (FHEFSSA) which mandated that Fannie and Freddie buy (securitise) a minimum of 45% of all loans which had been issued by depository institutions to people of low and moderate incomes. In 1995, the Treasury Department established the Community Development and Financial Institutions Fund (CDFIF) that provided banks with public money to be provided as additional subprime lending. The House Financial Services Committee (HFSC), comprised of top democrats Barnie Frank, Chris Dodd, and Chuck Schumer, enthusiastically championed these loosened credit initiatives.

The third legacy cause of the 2008 financial crisis concerned interest rates. Dysfunctional monetary policy in the period before the burst bubble(s) played-out over several years. As is often the case in matters of macroeconomics, its harmful impacts are best appreciated retrospectively. Specifically, in December 2000, the Federal Reserve had home loan rates pegged relatively high, at 6.5%. This created disincentive for real estate speculation. Indeed, it provided the last line of defence against profligate property buying on the part of those who may have been seduced by the subprime (so-called) opportunity. However, largely as a response to the burst dot-com bubble in March 2000, the cost of credit in the Western world was about to diminish. Specifically, in order to stimulate dampened demand, from January 2001 the Federal Reserve lowered official mortgage rates in the United States incrementally until they reached 1% in June 2003. There was a large increase in house buying and a concomitant rise in real-estate prices over this period. For example, property prices in the US increased by 70% between 2002 and 2006. In States like Florida and California, their price doubled (Austrade, 2008). However, such increases were also indexing another phenomenon; inflation, which in 2001 was 2.8% and by 2005 was 3.4% (Boyer, 2009; Labonte, 2018; Schwartz, 2009: 45). At this point (2005), talk of an economic stimulus was a distant memory and the policy agenda du jour began to focus narrowly on reigning-in consumer spending. Specifically, in 2005, the Federal Reserve again tightened interest rates. Under the Chairmanship initially of Alan Greenspan and then Ben Bernanke, they rose steeply, from 1% in June 2004 to 5.25% in June 2006 (Labonte, 2018). This 5-year u-curve effect was trapping real estate investors of dubious creditworthiness (i.e. those for whom the New Deal legacy elements were intended to aid) in circumstances where

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

they could not make their monthly repayments. However, at least for the moment, the same people were mostly able to claim that the properties they had bought had increased in value.

The fourth legacy cause of the 2008 financial crisis to be examined was not especially intended to help poor people and, as such, is perhaps better viewed as a catalyst than a New-Deal legacy factor. The issue here concerns repeal of the Banking/Glass-Steagall Act, 1933 in 1999. Glass-Steagall had separated depository and investment banking activities or, more precisely, restricted the capacity of depository banks and their affiliates to engage in securities trading. However, as a point of economic history, it is noteworthy that the official overturning of Glass-Steagall was largely inconsequential. In fact, from the early 1960s, federal regulators began taking an increasingly broad interpretation of its cross-fertilisation restrictions. Hence, by the time the Act was formally repealed (in the Gramm-Leach-Bliley Act (GLBA), 1999) commentators such as Wilmarth (2002) declared that the spirit of separation between depository and investment banking was – for all practical purposes – already a relic.

The role that abandonment of Glass-Steagall played vis-à-vis the financial crisis is subject to conjecture. At one extreme is Bill Clinton's, likely partisan, view about strategic flexibility. The argument here is that the less constrained arrangements formally implemented under his administration helped limit damage because, during the acute phase of the downtown, it was desirable for bank holding companies to acquire undercapitalised securities firms and/or change the way such troubled entities are incorporated. At the other extreme, economists mostly interpret repeal of Glass-Steagall as indefensible regulatory failure. For example, Martin Mayer – who in his book *The Bankers* (1975) had flagged concern about Citibank establishing a liquid secondary market in negotiable certificates of deposit and hence funding its activities through a shadow banking operation – has made this case. He later argued that repeal of Glass-Steagall counts as a clear-cut distal influence on the global financial crisis (Mayer, 2009). He proposed that commercial and investment banking have little in common and require different knowledge bases and skill sets, repeal made it possible for banks to take risks that they did not understand and, network integration increases contagion if problems arise.

Conclusion: Neoliberalism and lingering efforts to aid poor people as precursors of the 2008 financial crisis

Whether assessed through measures of annual income or net capital accumulation, from the late 1970s until 2008, wealth in OECD countries had transmuted from being near normally distributed – albeit with some positive skew[7] – to being bimodal in nature (Piketty, 2014). In sociological terms, the middle class has shrunk as large sections of it have been relegated to lower echelons. Putting aside Wilkinson and Pickett's (2010) compelling thesis that growing inequality is likely to be a more pernicious problem than was thought, the jury is no longer out on whether – under the influence of neoliberalism – a rising tide would lift all boats. Indeed, there is consensus that this mostly does not happen, and has not happened in Western countries over the last 40 years.

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

In a public policy environment where there is ubiquitous application of the market solution as a universal panacea, there are lurking dangers in attempting – through piecemeal effort – to assist those who are falling behind. For example, initiatives aiming to succour people struggling to gain access to affordable housing may be a good idea in principle. However, the embedded lesson from the 1980s and 1990s is that contextual elements have a decisive influence on their efficacy. There is something of a contradiction here. Where there is abandonment of the overarching New-Dealist-era principle that wealthy people should subsidise those attempting to move-up an economic hierarchy through hard-core institutional measures such as progressive tax regimes, a central role for unions and affordable access to critical services, it is harmful to institute soft-core measures, such as no money-down housing loans. It is through understanding the implications of this paradox that analysists will make better sense of how distal elements of the 2008 financial crisis provided fertile soil for proximal factors to play out. The underlying message is that policies should be integrated and not piecemeal. To return to the analogy of a heart attack, atherosclerosis – insofar as the financial crisis was concerned – was comprised of two inert compounds. Although the first of these – neoliberalism – was, in many ways, a framework for social policy failure in and of itself, it would not have produced the crisis, in particular, without the presence of the second compound, a well-motivated intention to aid those seeking home ownership or wanting to turn themselves into minor investors. Indeed, an entirely market-based solution to the problem of providing credit to real-estate investors – arguably the instantiation of the neoliberal ideal – would, at least in the long-run, simultaneously restrict finance to those at risk of default and align executive remuneration with robust measures of their employing entity`s commercial performance. The lesson here is that piecemeal emphasis on aiding people who are not prosperous is likely to occasion an atypical-style housing bubble (or similar dysfunctional outcomes) when enacted in a milieu of otherwise unfettered deregulation and widespread application of the market principle.

Funding

The author(s) received no financial support for the research, authorship, and/or publication of this article.

Notes

1. It is beyond the scope of this article to give extensive detail about collateralized debt obligations (CDOs), suffice to say that they are an asset-backed security (ABS). They imply a promise to pay cash flows to investors based on how much is collected from the pool of bonds or other assets being held. CDOs pay investors in a prescribed order. They slice the pool of bonds/assets into ‘, which ‘catch’ the cash flow of interest and principal payments in order of seniority, so that ‘Senior’ tranches have first priority and are the safest. Thus, if cash collected by the CDO is insufficient to pay all of its investors, those in the lower tranches suffer losses first. CDOs are usually issued by special purpose entities. Originally, CDOs were diversified which means that they were made up of anything that generates yield – bank loans, junk bonds, emerging market debt, and so on. However, by 2006–2007, when the CDO market grew to hundreds of billions, they were not made from traditional loans but were mostly comprised of lower level (A or BBB) tranches recycled from other asset-backed securities, usually sub-prime mortgage-backed securities.

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

2. This matter is dealt with comprehensively by LeQueux and Peetz (2013) who argue that credit rating agencies in the pre-2008 era were mostly incompetent in appraising solvency.
3. One way to appreciate how a fall in real-estate prices impacts aggregate consumer demand is the 'housing wealth effect index' (e.g. Case et al., 2012; Case and Quigley, 2008). This principle states that each one dollar of housing wealth generates 6–8 cents of consumer spending. This would predict that, if a seven trillion dollar loss of property value occurs in 1 year, there would be a contraction in consumer outlay of at least 50 billion dollars the following year.
4. The Taylor rule specifies that in the long run, an independently operated central bank will raise interest rates by more than 1% for each 1% rise in the inflation rate.
5. A view which attaches primordial importance to public policy failure is only one perspective of the antecedents of the crisis. Although most concede that regulation failure played a role, it seems that many are reluctant to posit a causal connection between factors and/or do not identify some influences as superordinate. For example, McDonnell and Burgess (2013) merely note that four groups of factors played a role: (1) an inability of financial institutions to meet the claims of creditors, (2) the collapse of the US property market and the subsequent problem that sub-prime mortgagees had in paying their financial institution, (3) regulation failure; and (4) the flow-on effects into the real economy of banking institution failure. Other views (e.g. Bhagat and Bolton, 2014; Torres, 2010) portray the root problem of the crisis as being inappropriate incentives for risk-taking, excessive pay to bank executives and traders, and – apparently as an afterthought – inadequate or incomplete regulation (as opposed to – what is suggested here – bad regulation). The author finds accounts that take a partisan and/or anti-capitalist view to be unhelpful and/or unsatisfying. In particular, views that weight distal factors equally and/or do not seek to create a narrative about cause and consequence obscure understanding and – very importantly – make it difficult to assign blame.
6. An SEC filing is a financial compliance-related report which is submitted to the US Securities and Exchange Commission (SEC). Public companies, certain insiders, and broker-dealers generally have a statutory obligation to provide such documents so that investors can make a comparative assessment of their options.
7. Throughout the middle decades of the 20th century the distribution of wealth in Western countries was transitioning from being positively skewed (hump on the left, tail to the right), to being more normal looking. See Piketty (2014).

References

Acharya VV and Richardson M (2009) Causes of the financial crisis. *Critical Review* 21(2–3): 195–210.

Austrade (2008) *Australian trade commission annual report 2007–08*. Sydney: Austrade.

Basso C, Calabrese F, Corrado D, et al. (2001) Postmortem diagnosis in sudden cardiac death victims: macroscopic, microscopic and molecular findings. *Cardiovascular Research* 50(2): 290–300.

Bhagat S and Bolton B (2014) Financial crisis and bank executive incentive compensation. *Journal of Corporate Finance* 25: 313–341.

Booth P, Beenstock M and Butler E (2009) *Verdict on the Crash: Causes and Policy Implications*. London: Institute of Economic Affairs.

Bordo MD and Landon-Lane JS (2010) *The global financial crisis of 2007–08: is it unprecedented?* Working paper 16589, December. New York: National Bureau of Economic Research (NBER).

Boyer M (2009) La crise économique et ses conséquences sur l'emploi. Les cahiers de l'institut économique de Montréal, Montreal, QC, Canada, December. Available at: http://www.iedm.org/files/cahier1209_fr_0.pdf (accessed 10 October 2018).

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

Braedley S and Luxton M (2010) *Neoliberalism and Everyday Life*. Montreal: McGill-Queens University Press.

Campbell AL (2012) America the undertaxed: U.S. Fiscal policy in perspective. *Foreign Affairs* 91(5): 99–112.

Case A and Coates TN (2017) Fear and despair: consequences of inequity. In: Plough AL (ed.) *Knowledge to Action: Accelerating Progress in Health, Well-being and Equity*. New York, NY: Oxford University Press, 9–20.

Case A and Deaton A (2017) *Suicide, age, and wellbeing: an empirical investigation*. In: NBER (ed.) *Insights in the Economics of Aging*, NBER working paper 21279. Chicago, IL: University of Chicago Press, 307–334.

Case KE and Quigley JM (2008) How housing booms unwind: income effects, wealth effects, and feedback through financial markets. *International Journal of Housing Policy* 8(2): 161–180.

Case KE, Quigley JM and Shiller RJ (2012) Wealth effects revisited 1975–2012. *IDEAS* Working Paper Series from RePEc, St. Louis, MO. Available at: http://ideas.repec.org/p/cwl/cwldpp/1884.html

Chapman JI (1998) Proposition 13: some unintended consequences. Paper, Public Policy Institute of California. Available at: http://www.ppic.org/content/pubs/op/OP_998JCOP.pdf (accessed 10 October 2018).

Coibion O and Gorodnichenko Y (2011) Monetary policy, trend inflation, and the great moderation: an alternative interpretation. *American Economic Review* 101(1): 341–370.

Combe E (1996) *Précis d'économie*. Paris: Presses universitaires de France.

Community Reinvestment Act (1977) Public law 95-128, Title VIII, Sec. 802, Oct. 12, 1977, 91 Stat. 1147.

Connell R (2010) Understanding neoliberalism. In: Braedley S and Luxton M (eds) *Neoliberalism and Everyday Life*. Montreal: McGill Queens Press, 22–36.

Crawford C (2011) The repeal of the Glass-Steagall Act and the current financial crisis. *Journal of Business and Economics Research* 9(1): 127–133.

Crotty J (2000) Slow growth, destructive competition, and low road labor relations: a Keynes-Marx-Schumpeter analysis of neoliberal globalization. In: *KDEA-KSESA joint international conference on the future of the Korean economy in the context of globalizing capital*, Suanbo, Korea, 22 June, 1–54. Amherst, MA: Political Economy Research Institute.

Crotty J (2008) Structural causes of the global financial crisis: a critical assessment of the new financial architecture. *Cambridge Journal of Economics* 33(4): 563–580.

Davis K (2011) Regulatory reform post the global financial crisis: an overview. Report for the Melbourne APEC Finance Centre and the APEC Study Centre Regional Symposium: Enhancing Financial Policy and Regulatory Cooperation Responses to the Global Financial Crisis, Melbourne, VIC, Australia, 8–9 March.

Demyanyk Y and Van Hemert O (2009) Understanding the subprime mortgage crisis. *The Review of Financial Studies* 24(6): 1848–1880.

Essenburg TJ (2014) *The New Faces of American Poverty: A Reference Guide to the Great Recession*. Goleta, CA: ABC-CLIO.

Fairbrother P and Rainnie A (2006) *Globalisation, State and Labour*. London: Routledge.

Genter D (1983) Structure mapping: a theoretical framework for analogy. *Cognitive Science* 7(2): 155–170.

Getter DE (2015) The effectiveness of the Community Reinvestment Act. *CRS Report for Congress*, 7 January. Washington, DC: Congressional Research Service.

Gould A (2014) Le travail et l'emploi après la crise globale financière: émergence d'un nouveau agenda de recherche dans un monde en état de choc [Work and employment relations after the global financial crisis: emergence of a new research agenda in a shell-shocked world]. In:

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

Thwaites JD (ed.) *La Mondialisation: origines, développement et effets*. Québec: Les Presses de l'Université Laval, 300–314.

Gould A and Lokrou M (2012) The global financial crisis providing a new normal in an already globalised world: a time to refurbish employment relations theory. In: *49th annual conference of the Canadian Industrial Relations Association*, Calgary, AB, Canada, 29–31 May.

Gramm-Leach-Bliley Act (1999) Public Law 106-102, 113 Stat. 1338.

Haughwout A and Okah E (2009) Below the line: estimates of negative equity among nonprime mortgage borrowers. Federal Reserve Bank of New York: Economic Policy Review, July. Available at: https://www.newyorkfed.org/medialibrary/media/research/epr/09v15n1/0907haug.pdf (accessed 10 October 2018).

Holmes A and Horvitz P (1994) Mortgage redlining: race, risk, and demand. *The Journal of Finance* 49(1): 81–99.

Issawi C (1979) The 1973 oil crisis and after. *Journal of Post Keynesian Economics* 1(2): 3–26.

Kauder B and Potrafke N (2015) Globalization and social justice in OECD countries. *Review of World Economics* 151(2): 353–376.

Kemp CD and Conte JV (2012) The pathophysiology of heart failure. *Cardiovascular Pathology* 21(5): 365–371.

Kolm SC (1977) La grande crise de 1974. *Annales. Économies, Sociétés, Civilisations* 32(4): 815–823.

Krieger N (2008) Proximal, distal, and the politics of causation: what's level got to do with it? *American Journal of Public Health* 98(2): 221–230.

Kroszner RS (2008) The Community Reinvestment Act and the recent mortgage crisis. Board of Governors of the Federal Reserve System. Available at: https://www.frbsf.org/community-development/files/cra_recent_mortgage_crisis1.pdf (accessed 10 October 2018).

Labonte M (2018) Monetary policy and the Federal Reserve: current policy and conditions. CRS Report for Congress, Congressional Research Service, Washington, DC, 9 January.

LeQueux S and Peetz D (2013) Between 'too big to fail' and 'too small to matter': the borderless financial crisis and unions. *International Journal of Manpower* 34(3): 198–212.

LoDuca M and Stracca L (2014) *The effect of G20 summits on global financial markets*. Working Paper Series No. 1668, April. European Central Bank. Available at: https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1668.pdf (accessed 10 October 2018).

Lokrou M and Gould A (2014) Sunny days, rainy days and hurricanes: the consequences of catastrophic economic events for work and employment relations. In: *51st annual conference of the Canadian Industrial Relations Association*, St. Catharines, ON, Canada, 29–31 May.

Mayer M (1975) *The Bankers*. New York, NY: Weybright and Talley.

Mayer M (2009) On credit default swaps. Comment at American Institute of Economic Research, 25 June. Available at: https://ritholtz.com/2009/07/martin-mayer-on-credit-default-swaps-comments-at-aier-june-25-2009 (accessed 5 November 2018).

McDonnell A and Burgess J (2013) The impact of the global financial crisis on managing employees. *International Journal of Manpower* 34(3): 184–197.

Mishel L, Bivens J, Gould E, et al. (2012) *The State of Working America*. Ithaca, NY: Cornell University Press.

Moody K (2007) *US Labor in Trouble and Transition: The Failure of Reform from Above, the Promise of Revival from below*. London: Verso Books.

Park K and Gould A (2017) The overlooked influence of personality, idiosyncrasy and eccentricity in corporate mergers and acquisitions: 120 years and six distinct waves. *Journal of Management History* 23(1): 7–31.

Piketty T (2014) *Capital in the 21st Century*. Cambridge, MA: Harvard University Press.

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press

Putnam RD (2001) Social capital: measurement and consequences. *Canadian Journal of Policy Research* 2(1): 41–51.

Schularick M and Taylor AM (2012) Credit booms gone bust: monetary policy, leverage cycles, and financial crises, 1870–2008. *American Economic Review* 102(2): 1029–1061.

Schwartz AJ (2009) Origins of the financial market crisis of 2008. In: Booth P, Alexander J, Beenstock M, et al. (eds) *Verdict on the Crash: Causes and Policy Implications*. London: Institute of Economic Affairs, 45–50.

Simkovic M (2013) Competition and crisis in mortgage securitization. *Indiana Law Journal* 88(1): 213–272.

Strickland JT (2004) The proposed regulatory changes to Fannie Mae and Freddie Mac: an analysis. *North Carolina Banking Institute* 8(1): 267–288.

Tarr DG (2010) The political, regulatory, and market failures that caused the US financial crisis: what are the lessons? *Journal of Financial Economic Policy* 2(2): 163–186.

Tickell A and Peck J (2003) Making global rules: globalization or neoliberalisation. In: Peck J and Yeung H (eds) *Remaking the Global Economy*. London: SAGE, 163–182.

Torres R (2010) Incomplete crisis responses: socio-economic costs and policy implications. *International Labour Review* 149(2): 127–137.

Weisbrot M and Ray R (2011) *The scorecard on development, 1960–2010: closing the gap?* Working paper no. 106. New York, NY: Department of Economic and Social Affairs.

Wilkinson R and Pickett K (2010) *The Spirit Level: Why Equality Is Better for Everyone*. London: Penguin Books.

Wilmarth AE Jr (2002) The transformation of the U.S. financial services industry, 1975–2000: competition, consolidation, and increased risks. *University of Illinois Law Review* 2002(2): 215–476.

Author biographies

Anthony M Gould is professeur titulaire (full professor with tenure) at Laval University in Quebec City, Canada. He has held professional jobs in five countries, including in senior executive roles in large government agencies. Professor Gould has been a visiting research professor at the Griffith Business School in Queensland, Australia since 2011, a visiting research fellow at Cornell University's Institute of Labour Relations and visiting professor at universities in the Middle East and Asia. He has authored articles about management, employment relations and labour market economics that are published in world-class peer-reviewed journals and have been cited extensively. Professor Gould is currently editor-in-chief of the scholarly journal, *Relations industrielles*, the oldest publication of its kind in the world.

Milène R Lokrou is a PhD student in industrial relations and a sessional lecturer at Laval University in Quebec City, Canada. She has delivered peer-reviewed conference papers at national-level conferences. Her research interests focus on temporary agency work, internal labour market dynamics, economic crises and employment/work-related public policy.

https://doi.org/10.1177/1035304618810974 Published online by Cambridge University Press