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Book Reviews

BOOK REVIEW THE CRISIS OF RISK. SUBPRIME DEBT AND US FINANCIAL POWER FROM 1944 TO PRESENT, BY SCOTT M. AQUANNO, 189 PAGES, EDWARD ELGAR, CHELTENHAM UK, 2021, ISBN 978180037082.

This book explores the *long* history of the 2008 subprime crisis and places it into the perspective of the post-Second World War history of financial markets and the development of the international bond market over the last 75 years. In this perspective, the demand for dollar debt is not reduced to US trade patterns or purely quantitative risk measurements, but is rooted in the US financial hegemony as shaped by the (ever changing) institutional settings of the international financial system since the 1940s. This offers a view of the subprime crisis that focuses on the intimate relationship between mortgage-backed securities and the international bond market as actively managed by US regulators in the Federal Reserve and Treasury Department. For this reason, it provides deeper historical connections of the 2008 crisis than those stemming from interpretations that only underline the contradictory nature of the US neoliberal regime of accumulation.

The book consists of an introductory chapter and three parts entitled respectively, Abstract risk and US financial power (Part I), The deep history of the subprime crisis (Part II) and The subprime crisis as the crisis of risk (Part III).

Chapter 1 (*Subprime markets in global capitalism: history and contradictions*) clarifies Aquanno's approach which starts from an institutional Marxist framework and builds on the tradition of cultural political economy associated with Sum and Jessop (2013) who identify institutional formations as important entry points for studying the social world. According to Aquanno (2021: p. 7), institutions evolve through a "combination of durable economic structures and discursively embedded human subjects" and the origin of the subprime crisis is poorly understood if the collapse of US mortgage debt is disjunct from the specific evolution of abstract risk in the international bond market. In his view, financial markets "are organized by diffuse, imperially constituted definitions of risk that have their basis in, but cannot be reduced to, material economic relations. This abstract form of risk is expressed as a financial common sense, offering a cognitive lock which reduces the complexity and uncertainty of financial exchange"

(Aquanno, 2021, p, 8). This explains why the international demand for US debt has always vastly exceeded the United States' share of global GDP. Financial markets and socially constructed ideas of credibility rely enormously on state institutional resources and are configured by monetary systems developed at the international level.

Chapter 2 (*Risking finance*) criticizes the standard way of calculating financial risk according to which different quantitatively determined market uncertainties (credit risk, liquidity risk, currency risk and so on) are merely stacked up and financial actions are ruled by agents matching their risk tolerance and measurable risks within financial instruments. In this view, in fact, financial rationality and actions are detached from the web of social power and knowledge influencing the financial system and cannot explain waves of mania, feverish speculation and overbanking that characterise financial markets as stressed by Kindleberger, Minsky and Strange. Aquanno, however, points out that the concrete forms of risk are emergent from, and subordinate to, a deeper system of financial control. Therefore, he also criticizes the narrow view which sees investors as simply speculative, irrational and insensitive to risky and volatility. Risk mitigation through specific rules, instruments and institutions is in fact a central feature of financial practice and acts as a model of economic conduct within financial firms and markets.

Chapter 3 (*The power of debt*) recalls Keynes's and Weber's emphasis on the influence of social norms and social relations on financial valuations and builds the concept of risk imaginary as shaped by monetary and political arrangements. It is argued that the Bretton Woods international monetary system, like the dollar standard which followed in the 1970s, formalized a broad understanding about the risklessness of US debt obligations that acted as an interpretative framework for global firms and investors. As written by Aquanno (2021, p. 33), "while the institutional systems sustaining the credibility of US debt instruments have been recalibrated over time, there is a basic continuity in the way market outcomes have been influenced by tacit systems of knowledge informed by patterns of imperial power." In this respect, following Lapavitsas's and Uno's analyses of the interconnectivity between security instruments from the simple to the more complex, Aquanno reconstructs the international financial risk credit pyramid which anchored the global financial system to US Treasury debt and functioned as an objective force within financial markets. In the case of US risk power, the first tier of the pyramid, representing the most basic pattern of social trust, consists both of US dollar obligations and US Treasury

assets whose unity is realized by their common dependence on the perceived credibility of the US Treasury Department; the second tier is composed of dollar denominated corporate/private debt; the third tier consists of non-dollar denominated private issue bonds.

Chapter 4 (*International bonds and the Bretton Woods era*) starts the second part of the book and begins to trace the postwar development of the international bond market in order to explore the deep history of the subprime crisis. It shows how after the Second World War the demand for US debt was strictly tied to the credibility of the US state and how policy decisions influenced the expression of financial demand. As the new Bretton Woods Agreement mixed with old institutional settlements and the evolving expression of US state power, international bonds were increasingly denominated in US dollars. By the beginning of the 1960s, foreign exchange reserves held in dollars exceeded 90 per cent. Moreover, there was an increase in the foreign purchase of both public and private dollar denominated bonds. Finally, offshore dollar holdings (Eurodollars) expand, enabling European banks and investment firms to offer dollar bonds outside the US market.

Chapters 5 (*Volcker and the dollar standard*) and 6 (*Bonding global markets*) continue the historical account until the mid-2000s of the development of the international bond market centred around US Treasury debt. After the breakdown of Bretton Woods in 1971 which stemmed from intensified global competition and high wage settlements squeezing US corporate profitability, a new system of floating exchange rates based around US financial control was constructed. In the 1976 Jamaica conference, the IMF articles were revised and countries were called to maintain smooth short term fluctuations on the dollar exchange rate, remove capital and current account restrictions and use the dollar as an intervention currency. Later on, Volcker shock in 1979 amounted to a ruthless and historic attack on American workers. Along with market-enhancing reforms and the ongoing globalization of production, Volcker's monetary policy restored US capital profitability, stabilized the dollar against inflationary depreciation and enhanced the Fed's political autonomy, giving rise to a new era of central bank independence. Moreover, the United States became a persistent net borrower to the rest of the world that supported the development of the US domestic-international market. Key European financial circuits became further tied into short-term dollar funding markets, and firms in London and across the continent stockpiled US debt obligations. Similarly, Asian markets and investors were increasingly drawn into the orbit of US risk power,

albeit in ways that were different from those in Europe. Finally, as an effect of the third world debt crisis in 1982 that affected the solvency of major US and European banks, a shift from bank credit to bond credit took place, altering financial dynamics and the nature of state financial management.

As shown in Chapter 7 (*Regulating risk*), US financial regulators played a key role in managing the international bond market and did so in a way that strengthened the dollar basis of global debt markets, often exploiting financial crisis to introduce new instruments that expanded US risk power. An example is provided by the extension to offshore bond market of US state's lender-of-last resort responsibilities. While a permanent solution to this problem only emerged in 2008 when unlimited swap lines of credit were established between key central banks, the Fed's decision to provide emergency assistance to Franklin National Bank in 1974 was a major step forward. This bank, in fact, was closely connected to the European banking system and Eurocurrency and bond markets. Therefore, Fed's intervention bolstered the confidence of private international financial operators that the Federal Reserve would backstop liquidity in these markets and favoured their further development.[1]Another example is given by Saudi officials' access to Treasury obligations outside competitive auction at a cheaper price that linked Saudi Arabian oil surpluses to US domestic-international bonds. Finally, the gradual erosion of Glass-Steagall regulations and privatization of currency and interest rate risk encouraged market-based financing relative to bank credit.[2] The state's motivation in this respect is not easy to decipher, but regulators were keen to favour the growth of complementary markets to diversify risk: in 1999, Greenspan praised the ability of credit markets to substitute for the loss of bank financial intermediation during a moment of distress.

Part III looks closely at the subprime crisis, specifically in terms of the financial relations and conventions underwriting the development of subprime finance. Chapter 8 (*The risk crisis*) shows that the expansion of US subprime debt relied on the very same hub-and-spoke financial system that emerged through the accumulation of US debt in the 1960s and 1970s as investors continued to privilege US public and private debt placements due to their perceived risklessness. Chapter 9 (*Management renewed*) extend this discussion focusing on how US financial regulators managed to prevent the crisis from completely destroying the global financial apparatus and extended US risk power, repeating previous actions and further internationalizing dollar denominated bond. As Aquanno (2021, p. 134) states "US officials organized the most sweeping intervention in the history of

global capitalism, first arranging and providing loans to troubled firms, then backstopping key markets". In the process, the Fed seemingly focused less on troubled institutions and more on key markets underpinning the financial system. Finally, Chapter 10 (*The future of risk in the era of authoritarian capitalism*) concludes the analysis by focusing to the institutional level transformations occurring at the Federal Reserve that significantly expanded Fed's penetration into financial markets and its ability to supervise key firms.[3] While corporate bonds can still default, unlike Treasury and presumably GSE (government-sponsored enterprise) agency bonds, the market is now generally backstopped by the Fed's balance sheet and linked to the US state in a way that ensures future worth. Any further extension, entailing the direct guarantee of specific bonds, would presumably mark a wider transformation of economic relations.

Summing up, Aquanno's book contains several interesting insights into the development of financial markets since the Second World War and their regulation by the State. According to him, State institutions support the conditions for capitalist development but also possess a degree of autonomy, containing and mediating relationships among the various fractions of capital and between subordinate and dominant classes. In the case of the United States, US risk power benefitted "not only the financial bloc through deeper and more dynamic markets, but industrial interests as well, providing access to cheap sources of capital and international pools of dollar credit" (Aquanno, 2021, p. 95).

Three more points in Aquanno's book are worthy of note. First, it shows that in the last forty years, Treasury department and FED have become ever more important centres of power. Second, it stresses that inflation targeting greatly extended workers' insecurity imposed by the Volcker shock ensuring a degree of permanent class discipline. Third, the relevance of State institutions for the development of financial markets is also shown when discussing the inability of the euro to replace the dollar in the international payment system. Although the euro was the preferred currency for new issues in the international bond market from 2003 to 2009 and in these years the countries of the eurozone increased their share of gross world economic output, the eurozone crisis has highlighted that the economic and monetary policies supporting the euro remain fragmented and uncertain. The continued mixture of budget cuts and frozen credit channels weakened the real economy throughout the region. Still more important is the fact that the ECB's lender-of-last-resort functions continue to appear politically fragile despite the rather massive quantitative easing programme started by Draghi

in 2015.

A note of perplexity can be advanced when closing this review. In the last chapter Aquanno states that the greatest threat to US risk power comes from within its domestic borders because neoliberal class rule has led to the fragmentation of American civil society and a significant erosion of the living standards of the working class. These are phenomena which play a central role in those interpretations of the subprime crisis that underlie problems in the US economy and contradictions of finance-based accumulation. It seems therefore that these interpretations may not be so misleading in interpreting the crisis although we must recognize the importance of how and why US mortgage bonds gained international credibility and global prominence.

Notes

1 The Franklin bailout formed part of an emerging strategy of protecting systematically important financial firms as in the cases of the Bank of the Commonwealth in 1972, the First Pennsylvania Bank in 1980, the Seafirst Bank in 1983 and the Continental Illinois in 1984.

2 Though securities markets always played an important role in the US financial system, banks remained a leading source of funding into the 1970s accounting for 62 per cent of total US lending in 1974. However, the bank share of total loans fell to about 30 per cent by 2007 as corporations shifted towards market-based financing and issued debt securities such as bonds and commercial papers. The decline of bank credit coincided with the securization of US mortgages. While securitized bonds were virtually non-existent in the mid-1970s, by 2007 they accounted for over 30 per cent of all US loans. Tax reforms and Basel accords favoured these changes.

3 From 2008 to 2014, the number of restrictions and regulations imposed by the Federal Reserve Board increased by 70 per cent.

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