US DOLLAR-BASED FINANCIALIZATION IN THE 2000'S: DRAWING THE BIG PICTURE OF MODERN CAPITALIST ECONOMY

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“No one saw this coming”

- Anticipations of the Global Financial Crisis (GFC) of 2008 and great recession. (Bezemer [2009])

- No Marxist in the list.

- Focusing on accounting model of financial institutions.

- Marx’s himself analysis of financial instability: basically, general industrial and commercial crisis founded on industrial capital accumulation. (type 1) (Itoh and Lapavitsas [1999])

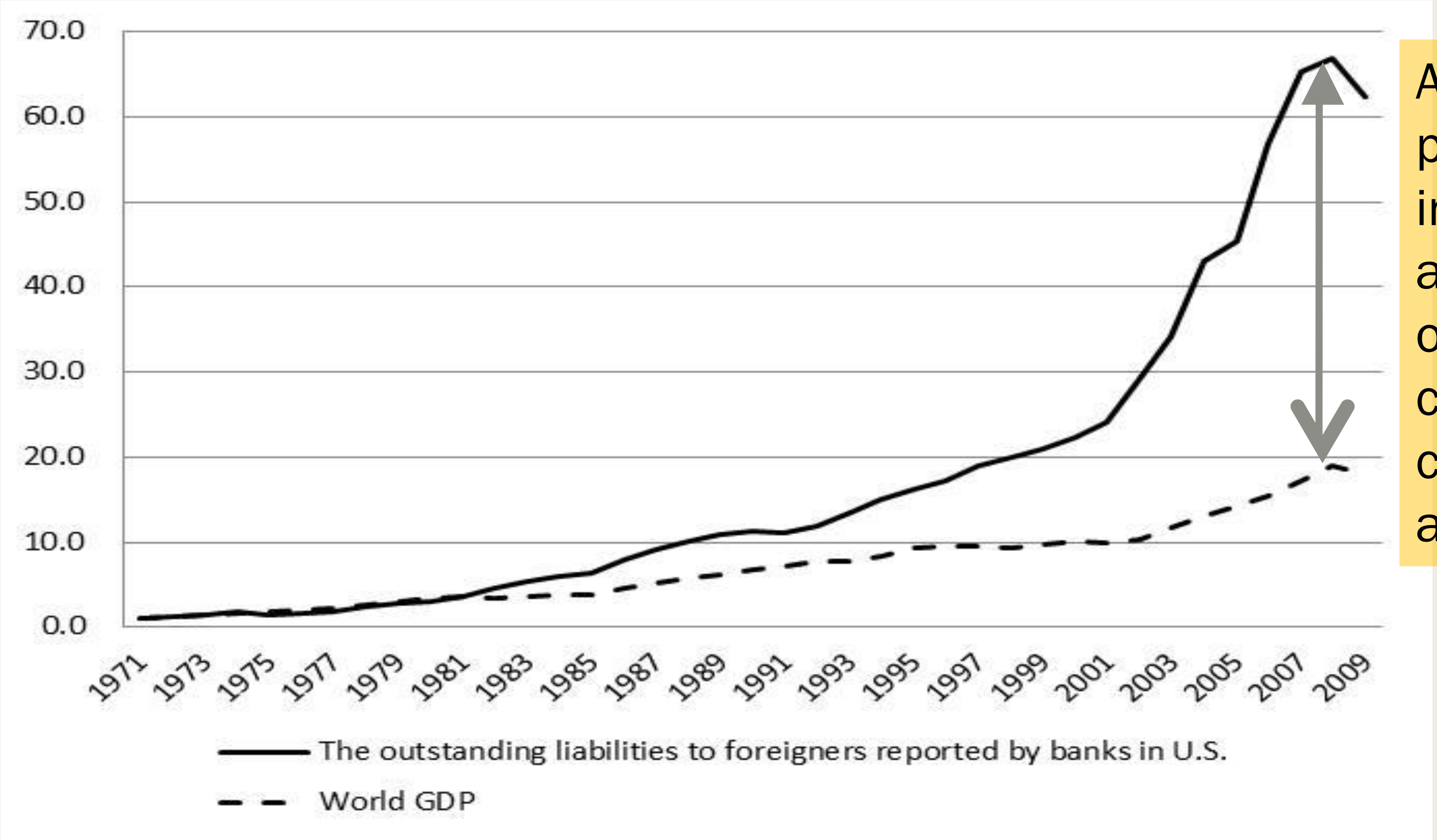
Why Minsky matters?

- The endogenous transformation from financial robustness to fragility that leads to financial crisis in modern capitalist economy.

- “…the internal working of a capitalist economy generate financial relations that are conducive to instability…”(Minsky [1982])

- “Karl Marx and John Maynard Keynes belong on the list of great economists who held that the capitalist process is endogenously unstable.” (Minsky [1982])

The autonomous expansion of USD-denominated financial assets in comparison with world GDP (1971=1)



A historical phase of independent accumulation of fictitious capital from capital accumulation.

Marxian analysis of financial instability

- Monetary crisis appears as independent from industrial capital accumulation. (type 2) (Itoh and Lapavitsas [1999])

- Ivanova [2012]; Hossein-zadeh [2014]; Lapavitsas [2013]; Chesnais [2016]; Kincard [2016]; Durand [2017].

- "For Marx, the ultimate origins of all cries lie in the "real" economy of production and exchange."(Ivanova [2012], p.59)

- The 'two layers of structural surplus of money capital' view: on one hand, the surplus of money capital relative to the stagnation in capital accumulation since the 1970's. On other hand, the surplus of money capital owing to the global shortage of eligible safe assets since the 2000's. (Takada [2015])

The main objective of the paper

- Based on the two layers view, we discuss how USD-denominated money capital is assembled, works, and is steered on a global scale, resulting the explosion of USD-denominated fictitious capital in the 2000’s.

- Finally, we show the USD-denominated financialization can be regarded as a distinctive historical accumulation, which is independent from the accumulation of real capital.

Marx’s credit theory

- Essence of interest-bearing capital (IBC): the metamorphosis of M-(W-P-W’-)M’.

- Movement form of IBC: commercial banks obtain profit by advancing loanable money capital as IBC through loans and investments on bonds.

- Sources of loanable money capital (liabilities side of bank’s balance sheet): gathering idle money from original money capitalists and labourers.

- Credit-giving operation (assets side of bank’s balance sheet): various credit monies such as banknotes and bank deposits.

Marx's credit theory (con.)

- Character: autonomous and independent expansion of fictitious capital relative to accumulation of real capital.

- Role: financial intermediary by commercial banks in contributing to capital accumulation in functioning capitalists.

The quotation from “money capital and real capital” (ch.30-32)

- “…the accumulation of loan capital is augmented by these elements that are independent of genuine accumulation… must lead to a regular plethora of money capital at certain phases of the cycle, and this plethora develops as the credit system improves.” (Marx, Capital Vol. III, pp.639-40)

A stylized example of a commercial bank's balance sheet which Marx explains

Assets	Liabilities
+ Loans and bonds	+ Deposits

Supplying money capital toward functioning capital

Fictitious capital

Gathering idle money from original money capitalists and labourers

Financial intermediary

The appearance of surplus of money capital at certain phases of business cycle

First layer of the surplus of money capital

- The monopoly-finance capital view (Forster and Magdoff [2009])

- According to the view, the surplus of money capital, resulted from chronic overcapacity in capital accumulation in advanced countries since the mid-1970's, are steered for the development of finanlization.

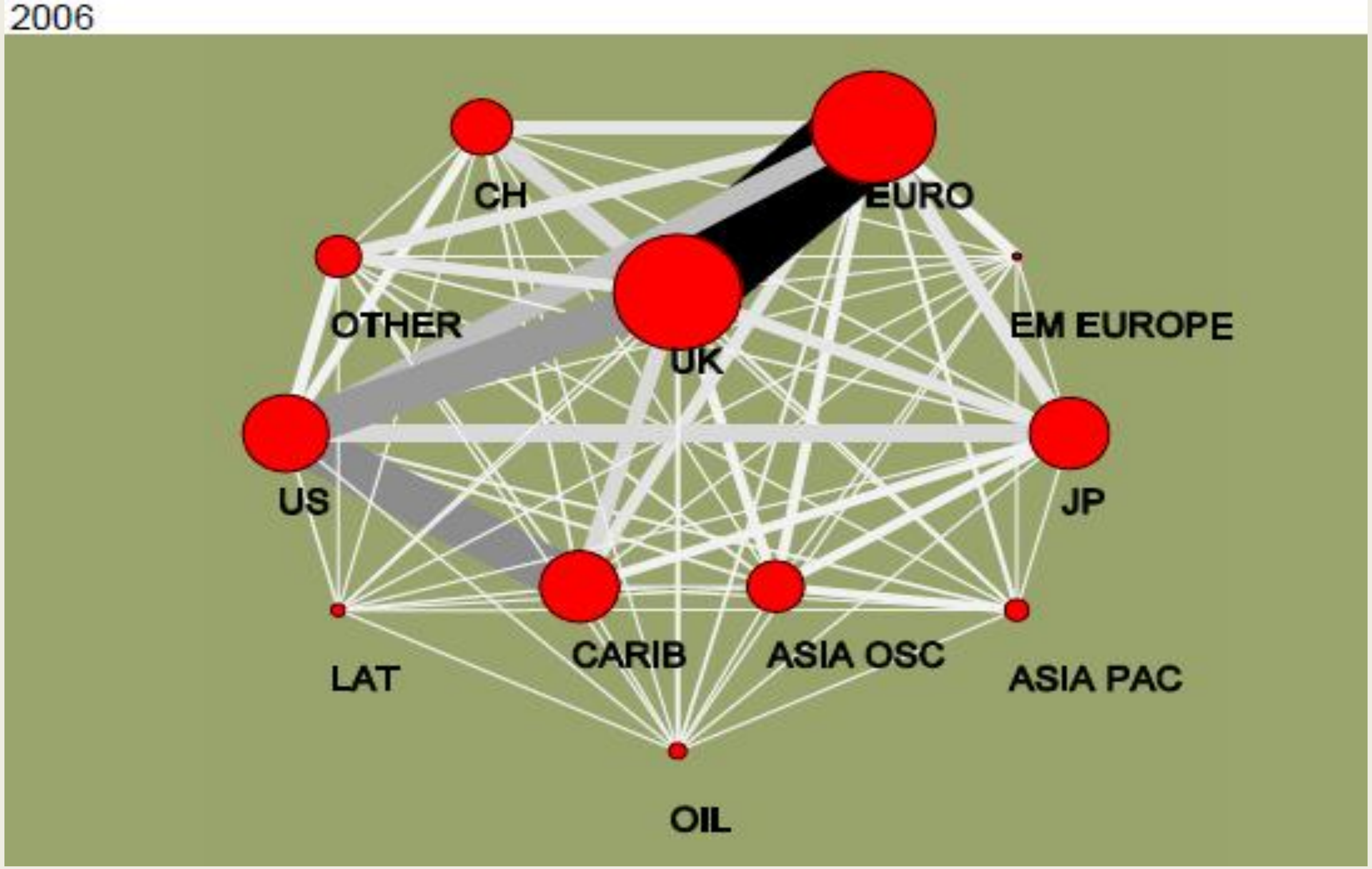
Various sources of money capital in the 2000’s

- The accumulation of cash pools in multinationals and wealthy people, led by the development of offshoring and the increase in inequality, respectively.

- The accumulation of dollar reserves in emerging countries under “the Bretton Woods system II”.

Where are the surplus of money capital assembled?: offshore financial centers (OFCs)

Linkages in the international banking system



Taken from BIS (2006)

Eurodollar market in London

- Specifically, most of surplus dollars, outside of the U.S. control, have been accumulated in Eurodollar market in London, the biggest offshore financial center (OFC) with lax regulation and lightly financial supervision, since the 1960's.

- "City of London's operations have funded, at low cost, both the UK trade deficit in goods and the outflow of foreign direct investment…Furthermore, UK-based financial flows with the tax heavens, especially with 'UK offshore' centers, are part of the mechanism of financing Britain's balance of payments and for facilitating the flow of funds to other countries. (Norfield [2016], p. 211)

- Above all, London plays a critical role of endogenous and autonomous supply of global dollar outside the U.S. (Aglietta (1985); Tokunaga and Epstein(2018))

Second layer of the surplus of money capital: institutionalized money capital in OFCs

- Leading part of money capital: Institutional investors.
- The surplus of money capital held in OFCs is institutionalized.
- "The age of asset management". (Bank of England [2014])
- Institutionalized strategy: Searching for safe, short-term, and high-yield financial instruments alternative to bank deposits.

Creating shadow money in money hierarchy (Gabor and Vestergaard (2016); Murau (2017); Nersisyan and Dantas (2017); Sgambati [2018])

Regulated/ Dependence on capital accumulation

	Assets	Liabilities
Central bank	+ Any assets	+ Deposits in banks
Commercial banks	+ Loans and bonds	+ Current deposits
Investment banks	+ Any assets (collateral assets)	+ Repo liabilities
MMFs	+ABCP	+ MMFs shares

Traditional money

Shadow money

Unregulated and autonomous/ Independent from capital accumulation

Where were the surplus of Eurodollar recycled?

- The existing scale and competitive advantages in banking-related services accounts for London's premier position as global hub for collateral and liquidity management. (Lysandrou et. al. (2017))

- Since the middle of the 1990's, surplus Eurodollars in London have been used to finance, primarily, non-bank borrowers such as securities dealers, hedge funds, and other non-bank financial firms in the US through repo market (McGuire (2004), pp.74–76).

- Specifically, off-balance sheet vehicles such as SPVs and SIVs in OFCs, established by large complex financial institutions (LCFIs) in the U.S. and Europe, borrowed vast amounts of cheaper dollars through repos.

Second layer of the surplus of money capital and fictious capital: Enthusiastic searching for higher-yield securities

- The global shortage of eligible safe assets in the 2000's: the global shortage of U.S. Treasuries and U.S. Agencies in comparison with the strong demands from foreign investors.

- In response, the full development of securitization in the U.S. could issue endogenously private-label debt securities (MBSs, ABSs, and CDOs) with higher-yield almost as safe as U.S. Treasuries and U.S. Agencies.

- "With a stroke of the pen, the SEC also made mortgage-backed securities into liquid assets that could be swapped for cash in the repo market." (Bayoumi [2017], p.76)

- The independent accumulation of USD-denominated fictitious capital from capital accumulation.

Global issuance of asset-backed securities, 1999-2008

	Total issuance	
	(USD billions)	(percentages)
United States	**11,983**	**67.9**
Euro area	1,867	10.6
United Kingdom	1,689	9.6
Offshore centres	1,262	7.2
Australia	306	1.7
Japan	271	1.5
South Korea	80	0.5
Canada	80	0.5
Other countries	107	0.6
Total	17,644	100

Source: Reproduced from ECB (2009)

A stylized example of balance sheets at European banks' SIV

Assets	Liabilities
Long-term private-label debt securities with high-yield(MBSs, ABSs, and CDOs) in the U.S.	Cheaper short-term dollar funding (repos, ABCPs, and FX swaps).

The independent accumulation of USD-denominated fictitious capital

The institutionalized money capital

US shadow banking system

Eurodollar market

The integration of both markets → providing LCFIs with the opportunities for profits-making.

The financial intermediary through shadow banking system

- Essentially, the development of financial intermediary in the model can be considered as independent from capital accumulation.

- Exact margins at European banks are estimated only between 10 and 30 basis points (Thiemann [2012], p.44).

- Under the slight margin model, LCFIs have pursued excessive leverage, boosting a banks' return on equity (ROE), depending heavily on vast amounts of cheaper Eurodollar borrowings through repos.

- Actually, the level of ROE at LCFIs in the U.S. and Europe was consistently at or above 20% which was roughly double ROE in the nonfinancial sector. (Haldane (2010))

US Treasuries as the pivot of the explosion of USD-based financialization

- With the development of shadow banking system, its mode of financial intermediary becomes longer and more multiple than traditional banking system.

- Due to the longer and more multiple financial intermediation, it becomes difficult for moneyed capitals such as institutional investors and LCFIs to monitor precisely credit risk of their counterparty and ultimate borrowers such as subprime borrowers.

US Treasuries as the pivot of the explosion of USD-based financialization (con.)

- In order to liberate themselves from the restrain, LCFIs accumulate the 'collateral pool', part of which is consisted of U.S. Treasuries, to secure various financial transactions such as repos and derivatives in shadow banking system.

- The collateral pool is like high-powered money, analogous to the money-creation process based on central banks' reserves in traditional banking system. (Singh (2013))

- It should be noted that the dominant position of U.S. Treasuries as "global accepted collateral" in shadow banking system can be defined as the pivot to sustain the explosion of USD-based finanlization.

Conclusion remarks

- First of all, the surplus of USD-denominated money capital assembled in OFCs has, partly, been sucked into the explosion of USD-denominated fictitious capital created in US shadow banking system in the 2000's.

- Second, the USD-denominated financialization cannot be understood without the opportunities for profits-making to LCFIs by the integration of Eurodollar market and US shadow banking system.

Conclusion remarks(con.)

- Third, the dominant position of U.S. Treasuries as ‘global accepted collateral’ in shadow banking system can be defined as the pivot in the explosion of USD-denominated financialization.

- In conclusion, the explosion of USD-denominated financialization, led by second layers of the surplus of money capital, can be recognized as a distinctive historical accumulation, which is independent from capital accumulation in the 2000’s.

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