THE BANKING INDUSTRY: MONETARY POLICY TOOLS OR FIRMS IN A PROGRESSIVE GLOBAL FINANCIAL CHAOS

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ABSTRACT

Since the '70s of the last century, through a world interdependent growing single financial market, the banking systems have found themselves in a progressive turbulence. According to Roy Harrods' tough position against fixed exchange rates, we entered the second post gold standard epoch on 15 August 1971, triggering an oil standard, a monetary huge hyperinflation, up to Paul Volker strict policies in the '80's. In a huge liquidity trap, started by Greenspan in 1987, up to Bernanke who on 16 March 2008, with full QE according to the Federal Reserve Act Sec.13-3, as outlined in Robert Mundell Reconsideration of the twentieth Century's speech in the 1999 Nobel Prize winner address, shows that most of the monetary chaos has been always stemming from the tripping monetary authorities themselves.

After the 1979 world disorder, all the monetary instruments have led to a banking industry deregulations. First, the repudiation of the Glass Steagall Act with the Modernization Act, a tight control, after the 2008 derivative last bubble burst, up to the present contradictory monetary remedies: Dodd-Frank Act.

The long history of uncertainty from Edegworth mathematical physics, Wolfowitz econometric models, down to some sophisticated econometric models at the IMF and at the Fed, none could succeed in foreseeing any last decade event. Shortfalls in the mathematical approach to finance, too many vested interest operating, the irrational exuberance, have prevailed, the too big to fail approach, as portrayed by Andrew Ross Sorkin, columnist of the N.Y. Times in the year 2010, has started the road to a short of planned uncertain economy.

The Japanese syndrome as describe by Robert KOO in his 2009 Lessons from Japan Great Recession, has shown the inefficiency of any Keynesian remedy, not yet digested by all the vested interest. The secular depression and the Western economic crisis, as accepted by most of the financial literature and media, has actually been contradicted by the inmost spectacular economic growth in the East, where China has surpassed the USA GDP and the World GDP grew from 28 US$ trillions at the beginning of the new millennium to the present 90 US$ trillions.

The present sad return to a diffuse outline of inequalities and social economic injustice, the French perspective of (Piketty, 2014),Thomas Piketty, calls a return to the public market manipulations, which unfortunately, can bring only to the evident political race to the power of modern vested interests as depicted by Keynes in the year 1936.

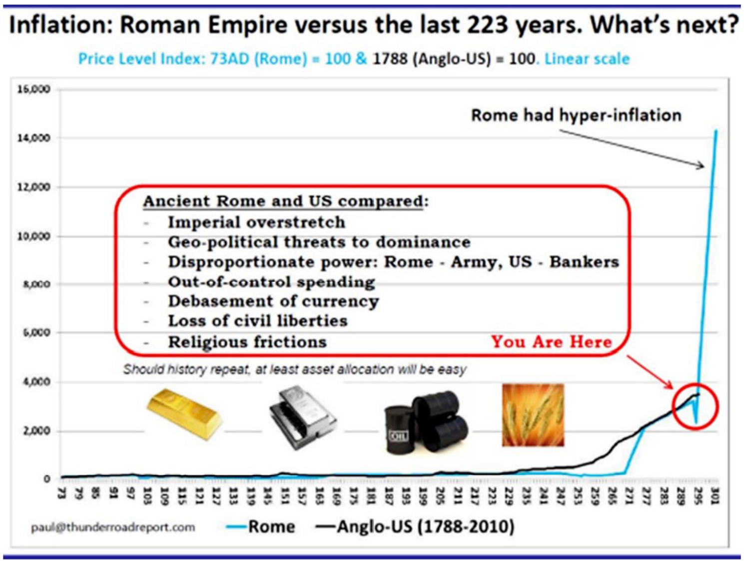
Keywords: banking, monetary policy, present crisis, recovery, interdependence
JEL classification codes: G21

INTRODUCTION

The dollar debasement, was finalized on the 15th of August 1971, in Camp David, where President Nixon assembled his key economic advisers in a panicked weekend retreat. Surrounded by economic advisers as Arthur Laefer tells (Arthur B. Laffer, 2011, 4), Nixon declared *"I have* *directed Secretary Connally to suspend* temporarily the convertibility of the American dollar *except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States".* So the dollar was pulled off the gold standard, changing definitely the role money played, until that moment since the Bretton Wood 1, where the Dexter White plan took effect, three weeks after the landing of the allied troops in Normandy. Definitively a worldwide system of fiat money, destroying the fixed exchange rates since then in force, took off to new horizons.

That decision, taken in a state of panic, set up a far-reaching deleterious series of consequences that would last for years to come, up to the present turmoil suggesting a Bretton Woods 2 solution to the present world monetary deep crisis and turmoil. In summary, Nixon imposed a 10% tax import surcharge, promoted a Job Development Credit in form of a tax credit on American Made investment products and a wage and prices control resembling the Diocletian Edict on Maximum prices dated A.D. 301

Figure 1 Roman denarius debasement.



The following President Gerald Ford, in the middle of the '70s started the WIN program, *whip inflation now*, when, as a logical consequence, prices really started to reflect the monetary expansion, once out of the gold discipline. The left WIN buttons still reflect that period.

During the following decades, up to this year, we have had some phases linked one another and expressing the evolution of the consequences enacted on that day in the year 1971:

- the inflationary seventies;
- the Paul Volker recovery efforts during the eighties, up to the NASDAQ sudden fall on the On Black Monday, 19.10.1987; the S&P 500© Index lost 20.5%, the Dow Jones Industrial Average (DJIA)© lost 22.6% and the NASDAQ Composite lost "only" 11.3%. However, this severe one-day US stock market crash also affected other international stock markets. At that time Alan Greenspan has been already for two months running the FED;
- the twenty years of Alan Greenspan leading the FED introducing the new era of recurring quantitative easing or the like, pulling liquidity as a remedy to any financial turmoil;
- the Chinese industrial revolution, after the Mao Tse-tung demise of the cultural revolution and the mutual Chinese and US recognition in Washington January 1979;

- the Nasdaq dot.com bubble, the 9/11 attack to he twins towers, the subprime and the final derivative bubble bursting in an unpredictable way, with an unusual contradictory resilient consumer price index stability and in a financial markets general ever growing figures.

All these events are strictly connected and are consequence of some panic decisions that in a retrospective profile look like a prevailing contradicting economic path, from the New Frontier to the supply side economics, to the monetary policies allowed by the free fiat money illusion, especially affecting financial markets manipulated values. "*In this and previous chapters we have seen that unstable money robs sometimes one class an sometimes another; that it upsets all sorts of calculations and economic relationships and adjustments; that it causes harmful fluctuations in trade and employment, and produces discontent, labor troubles, class hatred and violence; and that in the end it represents general economic loss. These evils of unstable money may be reduced to three: social injustice, social discontent and social inefficiency*" (IRVING, FISHER 1928, 105).

Let us remember the Jimmy Carter National Energy Plan, the excess-profit tax and the fighting queues at the gas stations, the gas price ceiling controls, the mandate temperature controls in government buildings and the air recycling order for airlines to save on fuel costs.

THE EVOLUTION

Along the implementation of the single euro currency, at the end of the inflationary '70s and after the Paul Volker restricting measures of the early 80s', three major stock market bubbles burst in the international financial arena. The first, the dot.com bubble in the year 2000, after the market closed at 10.395 on 27 September 1999, on October 2002 it was at 7.286.The related and consequent subprime rate bubble in the year 2007, few months after the Standard & Poor regained its 2000 value and, thirdly, the derivative bubble in the year 2008, as a likely final consequence of the monetary policies adopted by the FED in those twenty Alan Greenspan's years, still unsolved.

All these unpredicted events, out of any econometric prevision or control both at the FED and at the IMF, led to the present confuse unlimited recession, which, much more than a cycle shows an exit from the Columbian epoch and a definitive re-surfacing of Asia.

Meanwhile, the sovereign massive debt reached unbearable levels in many Southern Countries, challenging all the convergence criteria and reaching the annual GDP level in several countries:

- price stability, inflation should not to be over 1.5% of the average percentage points of the three best-performing Member States;
- the annual government deficit: it should not have exceeded 3% of national GDP;
- Government should have never exceeded the limit of 60% of national GDP.

Since the Keynesian revolution, the economic theories and economic policies, prevailing during these years were:

- a general opinion that the 20th century Great Depression should have been managed with monetary, rather than fiscal policies, (MUNDELL, 1999);
- hence any fiscal policy, according to Milton Friedman and the Chicago School, were commonly perceived as doomed to failure;
- thirdly, the trade-off between inflation and unemployment was accepted as an unavoidable final effect of an essential monetary expansion, lately defined quantitative easing, without too much concern for the purchasing power of money;
- the missing recovery and take off, after any kind of monetary expansion may be connected to the leading to a liquidity trap in a no inflation environment(J. R. RHODES, 2008).

"*We used to think," James Callaghan, told the Labour party conference in 1976, "you could spend your way out of a recession and increase employment by cutting taxes and boosting spending. I tell you in all candour that this option no longer exists..."*[119]

This attitude has lately been commented by several Nobel prize winners, among them (ROBERT LUKAS, 1995).

THE MONEY FUNCTIONS

As generally supporting policy framework and residual sources, after the dollar debasement consequences, the left theoretical structures used by most policy makers, during the three last decades in the 20th century, modern macroeconomic models were under scrutiny already at the end of the Century. (ROBERT LUKAS, 1996, 262). He was writing

"*But who can say how the macroeconomic theory of the future will develop, any more than anyone in 1960 could have foreseen the developments I have described in this lecture? All one can be sure of is that progress will result from the continued effort to formulate explicit theories that fit the facts, and that the best and most practical macroeconomics will make use of developments in basic economic theory."*

Furthermore,

"*It is no wonder that the integration of money into a neoclassical framework has been so difficult to achieve: neoclassical economics is fundamentally incompatible with the most important functions of money, which - as a medium of exchange - is to free people from the need to know the V, price of n-1 goods at all the times. Money exists because the real world is fundamentally non-neoclassical. Money and Walras do not mix.*" (RICHARD KOO, 2009, 308)

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Minsky's model of the credit system, which he called the "financial instability hypothesis" (FIH) (Minsky, Hyman P. 1992) incorporated many ideas already circulated by John Stuart Mill, Alfred Marshall, Knut, Wicksell and Irving Fisher.

"*A fundamental characteristic of our economy*," Minsky wrote in 1974, "*is that the financial system swings between robustness and fragility and these swings are an integral part of the process that generates business cycles*."

Disagreeing with many mainstream economists of the day, he argued that these swings, and the booms and busts that can accompany them, are inevitable in a so-called free market economy- unless government steps in to control them, through regulation, central bank action and other tools. Such mechanisms did in fact come into existence in response to crises such as the Panic of 1907 and the Great Depression. Minsky opposed the deregulation that characterized the 1980s.

[119]<http://www.newstatesman.com/search/google/Callaghan%20%20and%20candour?query=Callaghan%20%20and%20candour&cx=014587529549946006773%3Aq0ke2unon2y&cof=FORID%3A11&sitesearch=>

THE CRISIS

With the US$ debasement, the benefits of comparative advantage were then lost without a sound medium of exchange, to store vale and to work out the investments efficiency returns. Recrimination over unilateral trade policies made it more difficult to agree on other measures and to stop the large potential monetary base supply bubbles (BARRY EICHENGREEN, JEFFREY SACHS, 1986, 67-71).

The multilateral clearing mechanism, as developed between the two World Wars resulted inefficient and not able to restore the previous Hume model of comparative advantage by means of a self-regulating prices' system, as used to be the gold standard self-adjusting rule; the international trade did not take off and an epoch of autarchy was the result.

The shah of Iran Reza Pahlavi, after 37 years of ruling, left Teheran on 16 January 1979 for never return because of millions of protesters everywhere in the Iranian cities, forming one of the biggest humankind crowd. Never appeared before such a revolution, in a State, usually addressed as a miracle of modernization and economic reforms, controlling one of the biggest army as well as an effective secret police. The crowd was ready to die for a scholar living in exile in Paris, Ruhollah Mustafa Khomeini an elder Shiite scholar, a revolution leader who was not aiming to a secular modernization. His only desire was an Islamic revolution, which actually succeeded in disrupting the Communist rule in Central Europe and spread to the rest of the Arab world, a holy war called jihad, displacing most of the socialist principles.

On 3 May 1979, the Conservative Party, led by Margaret Thatcher ousted the incumbent labor government of James Callaghan with a parliamentary majority of 44 seats. The election was the first of four consecutive election victories for the Conservative Party, and Thatcher became the United Kingdom's - and Europe's - first female, the iron lady head of a government.

John Paul II, born Karol Josef Wojtyła, also known as Saint John Paul the Great, became pope of the Catholic Church on the 16th October 1978 and, a few months later, in June 1979, it is to his Poland that he makes his first of so many trips during his pontificate. A huge crowd came to listen to him in Warsaw's Freedom square and it is precisely at that moment that the Polish people realized how considerable his power was. Worker's strikes multiplied, leading to a destabilization of the Polish communist regime. At the end of 1981, when the government, running out of arguments, adopted the martial law, Solidarnost had 10 million members and was carried on by a deep social wave. For the first time since 1968 in Czechoslovakia, a communist regime was seriously shaken.

Christmas 1979 was the Russian first day of invasion of Afghanistan, the first Nation to recognize the October revolution in 1917. The Soviet war in Afghanistan lasted nine years, since December 1979 to February 1989. As a part of Cold War, it was powerfully fought between Soviet led Afghan forces against multi-national insurgent groups called the Mujahedin, mainly composed of two alliances: the Peshawar Seven and the Tehran Eight. The Peshawar Seven insurgents received military training in neighboring Pakistan and China, as well as weapons and billions of dollars from the United States, United Kingdom, Saudi Arabia, and other countries. The Shia groups of the Tehran fight alliance received support from the Islamic Republic of Iran. Early in the rule of the PDPA government, the Maoist Afghanistan Liberation Organization also played a significant role in opposition, but its major force was defeated by late 1979, prior to the Soviet intervention. The decade-long war resulted in millions of Afghans fleeing their country, mostly to Pakistan and Iran. Hundreds of thousands of Afghan civilians were killed in addition to the rebels in the war.

The initial Soviet deployment of the 40th Army in Afghanistan began on December 24, 1979, under Soviet leader Leonid Brezhnev. The final troop withdrawal started on May 15, 1988, and ended on February 15, 1989, under the last Soviet leader, Mikhail Gorbachev. Due to the interminable nature of the war, the conflict in Afghanistan has sometimes been referred to as the "Soviet Union's Vietnam War" or the "Bear Trap".

At the end of 1978, the septuagenarian Chinese, Communist Party leader Deng Xiaoping, after stabilizing the relations with the US, "*The Unite States of America and the People's Republic of china have agreed to recognize each other and establish diplomatic relations as from January 1, 1979*." (EZRA F. VOGLEI, 2011, 333) heaved himself to the top job introducing a series of economic reforms that ultimately changed the country beyond all recognition. Emulating closer reforms, he applied the successful free or special zones regimes of Singapore, Hong Kong, Taiwan and similar Special Economic Zones, to mainland and continental China. Adopting the Wealth of Nations' principles, he opened the Country, out of the extirpated Cultural Revolution and the little red book doctrine of Lin Biao, in a borderless free capitalistic enterprise regime. He finally attracted most of the industrial activities and capitals out of the expensive ruled welfare Western democracies, starting a new economic era for the Far East region and it is escalating financial centers.

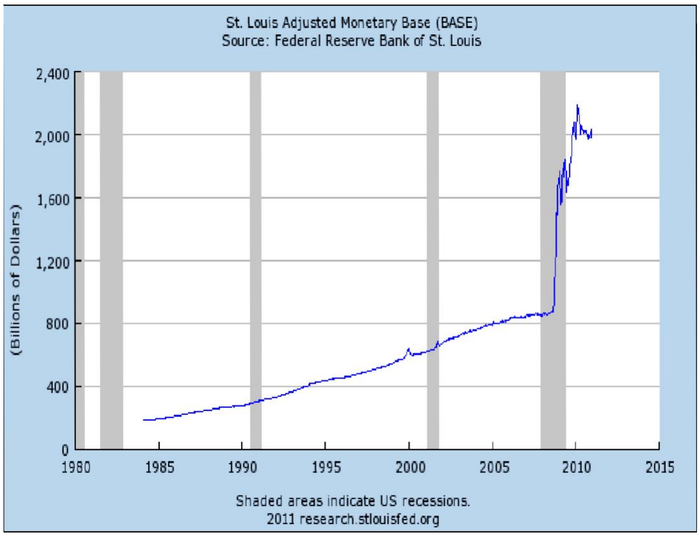
At same time, he and his colleagues planned the dissolution of the collective farms set up by Mao Zedong and permitted the peasantry to return to their old system of private family farming. These five figures, not correlated but performing their task in different areas in an already global economy, were the artificers in that year 1979 of an epochal social remodeling, marking the end of the great socialist utopia that had dominated so much of the twentieth century.

The huge literature about the demise of socialism, include even liberals bound to the prevailing welfare State theory reinforced after the American '60s movements started in Berkley, at Joan Baez notes. " ...economics inevitably takes place in a political context, and one cannot understand the world as it appeared a few years ago without considering the fundamental political fact of the 1990s: the collapse of socialism, not merely as a ruling ideology, but as an idea with the power to move men's minds." (PAUL KRUGMAN, 2009, 10).

In this way, at the end of the seventh decade of the twentieth century, the twin forces, markets and religion, discounted for so long after the enlightenment, came back vigorously on the world stage.

The three large free waves of monetary basis after the 1971 August debasement: the NASDAQ, 10 October 1987 slump, the 11/9 2001 Alan Greenspan's FOMC, led towards the subprime collapse in 2007. Successive quantitative easing huge funds, were assigned to Henry J. Paulson.

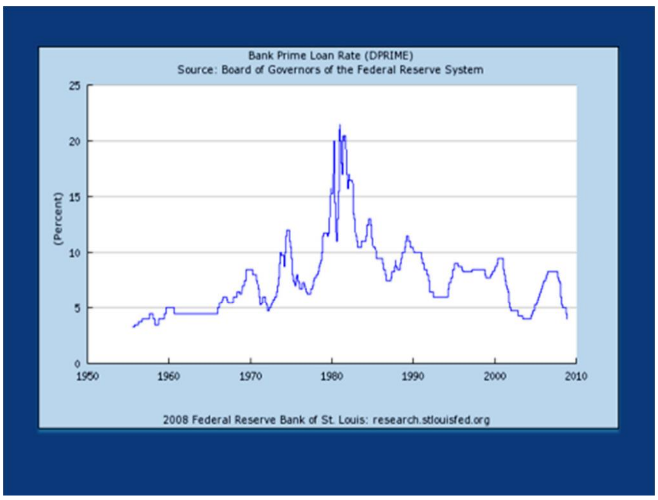
Figure 2 The monetary base increase



To save the Freddy Mac, the Fanny Mae and the Bear Starns acquisition by JPMorgan, Paulson obtained, in the year 2008,750 US $ billions. Such Congress fiat money provisions had, as fallout, the triggering of a great market bubbles leading the D.J. index towards 16.000, the great financial inflation ever in a world dominated by the great China resurfacing and recovering at in comparable low prices, dismantling the Western structure of cost and prices in the industrial technology. The crisis actually started in. the seventies and spread from the peripheral areas toward the center of the Western States, starting from the (S&L) saving and Loan Industry down to:

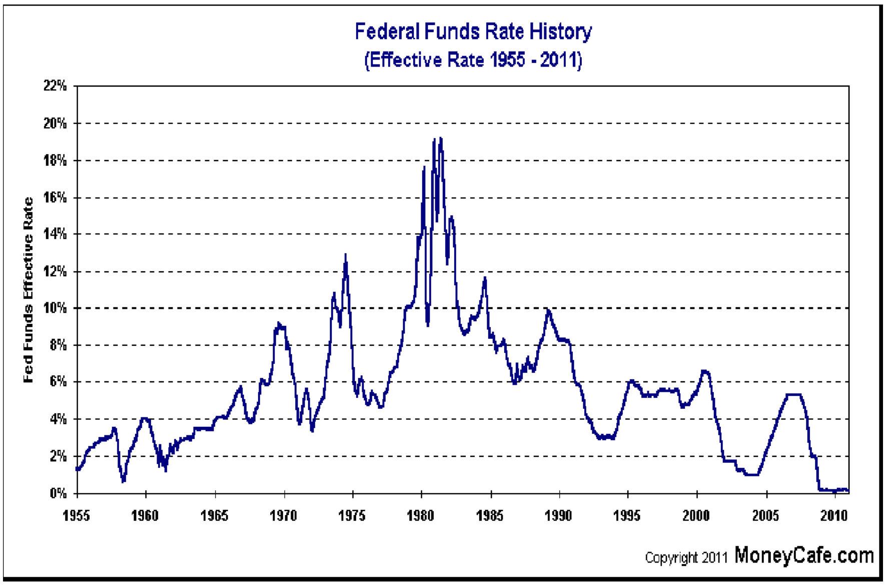
- S&L crisis 1980
- Japanese banking crisis 1990
- Drexel and Burnham
- December 1994 and early 1995 Mexico - Tequila Crisis
- Argentina
- Brazil
- The Philippines
- Poland
- 1997 Thailand
- Indonesia
- Malaysia
- October 1997, Korea
- August 1998, Russia declared a debt moratorium
- January 1999, Brazil exchange rate crisis
- Enron
- Worldcom
- Baring Bank
- Lehman Brothers
- Freddy Mac
- Fanny Mae
- Bank of America
- Wachovia
- Bear Stearns
- Merrill Lynch
- Morgan Stanley
- BNP Paribas
- Goldman Sachs.

Figure 3 Prime rates during the '70s and the '80s



..., in a sequence of insolvency, State acquisitions, public recapitalization, unbalanced accounting structures, in a frenzy re-regulation of the financial industry trough closer and stricter Basel criteria. The final conclusion, puts a doubt on the banking industry, are banks pursuing profit and therefore enterprises or, centers of social accountancy under the protection of a political lender of last resort, in order to close financials out of any risk of bankruptcy being *too big to fail* in an informal planned economy.

Figure 4 Federal funds rates



THE RESTRUCTURING PRESENT DILEMMA

Most of *clear and present dangers* come out of the relationship between deep deregulation during the eighties and strict macroeconomic restructuring financial guidelines requirements, like the Volker rule or the gold rule. These were enforced by the lending Authorities, mostly the IMF, the WB, and EBC as (SAP) Structural Adjustments Plans, and prefigure the political cost of both reshaping the public administration and reforming the welfare state as grown trough the cold war years and later.

A free market economy, under consumers' preferences and choices, is not able to allocate savings and investments according to political guidelines and it seems very difficult to obtain wide unconditional consensus, as long as the State is a factor of increasing public demand from a private consumption angle.

As a readjustment from a public swollen consensus demand, pursuing politically prearranged goals, to a concurrent contraposition between a civil society attitude and a contribution on a single member partnership statute, to a passive bargaining political consensus, based on individualistic vested interests, the gap seems now to be insuperable and not likely absorbed by available instruments.

Figure 5 Public debt increase

Here are the actual figures of what the total debt was when each president left office and the percentage increase:	
Ford,	$ 0.65 trillion 00,0%
Carter,	$ 0.93 trillion 42,0%
Reagan,	$ 2.68 trillion 189,0%
Bush,	$ 4.18 trillion 55.6%
Clinton,	$ 5.7 trillion 36,0%
Bush,	$ 10.7 trillion 75,0%
Obama	$ 17,2 trillion 67,0%

"*The financial crisis that began in the summer of 2007 should therefore be understood as an accelerator of an already well-established trend of relative Western decline*" (NIALL FERGUSON, 2011).

The consequence is a declining low profile welfare society, facing a new wave of capitalistic instruments, operating from the global new growing competition out of the classic everlasting economic goals, based on value, synthetic expression adding quality and price in a single competitive environment. The total growth of exports from Asia and the slow progressive substitution of western productions, were leading to an economic supremacy which ended in a surpassing Chinese GDP over the leading USA, undiscussed lead after the second world war and up to the unsuccessful planned economy experiment in the Eastern hemisphere.

The survival kit left by the financial institutions would have been able to satisfy a strenuous defense of the dying welfare State privilege, which would have endured as long as the Eastern financial centers would have supported it.

Now we must face the overcome of Chinese GDP, larger than the USA one and the misleading welfare policy financed only by deficit spending supporters as well by China. Asia has regained the previous economic level it used to have at the beginning of the new world discoveries, which kind of structural reforms are we now supposed to endure in order to keep our present income untouched, this is the final undisputable problem.

The structural adjustments are really a long and fatiguing experience since it is difficult to develop a sustainable industrial and services presence in the global economy if not developing a previous existing one.

CONCLUSIONS

Post-Keynesian scholar[120]Paul Krugman, in recent academic work, has collaborated with Gauti Eggertsson on a New Keynesian model of debt-overhang and debt-driven slumps, inspired by the writings of Irving Fisher, Hyman Minsky, and Richard Koo. Their work argues that during a debt-

[120]<http://en.wikipedia.org/wiki/Paul_Krugman#cite_note-158>

driven slump, the "paradox of toil"(Gauti Eggertsson, 2010) together with the paradox of flexibility, can exacerbate a liquidity trap, reducing demand and employment. The paradox of flexibility is that a debt deflation shock can create a situation where increased price and wage flexibility result in decreased total demand. This term was introduced by Paul Krugman and Gauti Eggertsson in the paper *Debt, Deleveraging, and the Liquidity Trap: A Fisher-Minsky-Koo Approach* (Arthur B- Laffer, 2011). The term was intended to complement the "*paradox of thrift*", a concept resurrected by John Maynard Keynes and Eggertsson's earlier work on the "*paradox of toil*".[121]Krugman and Eggertsson proposed that the paradox of toil and the paradox of flexibility mean that wage and price flexibility do not facilitate recovery from recessions during a liquidity trap, but actually exacerbate them.

The crucial point lies in the Keynesian lack of marginal capital efficiency, in a definitely new environment coming out of the dollar bi-debasements, one after the first World War, the second after he 1971 August panicking Camp David session, with identical consequences, roaring monetary inflated years, bubble burst ad depressions, 1915-1935 and 1971-2015.

In the year 1929, the recession turned in a depression and only the war impulse started a new expansion area. In the new cold war scenery, after the second debasement and related liquidity traps, in absence of adequate risk offsetting profits, the new Eastern Tigers attitude, in an open World economy, out of any welfare state boundaries, led to a definitive Western stagnation.
The decisive forces are now the floating exchange rates, the absence of adequate capital efficiency and the low wage and labor costs of the new industrial Asian States.

The strict interdependence, learned through the disappointing autarchic policies and nationalistic ideals in force the two World Wars, have led to the acceptance of a new realty where competition, cooperation and economic integration represent the translation of the first economist message.

The Wealth of Nations, by Adam Smith, written in the year of the independence declaration 1776has now become a best seller in all the Chinese bookshops.
The problem, at this very point of our history is the necessity of a new Bretton Woods 2, to face the tough slumps occurring all over the world and inappropriately named crisis. In reality, the problem arouse with the debasement of the dollar and the related convertibly are:

- the flexible exchange rate, linked to the external imbalances and therefore the weakening of the single currencies function as meter of value;
- the development of the huge structuring of derivatives to face foreign exchange risks;
- the promotion and sale of an amount of such financial products out of control and out officials evidence.

Furthermore, besides the close fallout over trading, imbalances and interest rate, as instrument of monetary policy, the market has developed further interest rates derivatives instrument which:

- have engulfed public administration, financial management procedures;
- generated huge losses in unpredictable events like tactical monetary policies swift changes like in the case of easy monetary policies and anti-inflationary measures.

Third, the tremendous expansion of progressively high quality and low price Asian industrial productions have left Western banks full of liquidity, with interest rates close to zero in not negative, and lack of opportunities in the real economy:

- the intervention of the FED, the Treasury and the TARP funds have managed to keep running the banking, insurance and automotive industries in a frozen uncritical market.

[121]<http://en.wikipedia.org/wiki/Paradox_of_flexibility_-_cite_note-eggertsson2010a-2>

During the years 2007 -2008, Henry Paulson, lived besides Timothy Geithner and Ben Bernanke until the 2009 Obama entrance at the White House, on the 20 January, the management of three TARP funds of 700 billion each, enlarging the already booming monetary base and assuming the largest ever internal deficit ever seen(Alan Greenspan, 2014, 103).

The almost socialization of the US largest industrial sectors have progressively reduced the role of North America in the world economic arena, and China has reached the largest World's GDP during this current year. Actually, the World is not in a phase of recession or depression, the West economies are suffering trade imbalances and high unemployment rates, but the World, over all, has enlarged its GDP three times since the first bubble burst at the beginning of the 21th first Century.

A revision of the monetary global interchange rates, the acceptance of some concurrence in the interdependent global market, the modernizing of the World political framework in a new dimension, reducing the gap between the technical technological and communication progress and the political frameworks is the major point. These infrastructures nowadays are mostly based on and old-fashioned communication styles, based on representative local relationships, with a limited perception of the present dangers, strictly related to the global activities of the financial institutions and the mobility of manufacturing entities require a wider scope and control.

At same time, the emerging new corruption scenarios and the liability of representative democratic structures, suggest a revision of public responsibility and responsibility of the persons willing to assume public role and leading positions. A discovery of the roles of the civil society, out of the competing political arena, where most of the units are often much more interested in their political role, than in the consequent responsibility they assume.

I would therefore stress the present real needed steps,

- the Bretton Woods 2
- the enlarging of the international political arena, with strict an empowered role of the IBS, the WB, the FMI and some new comers and the widening role of public social networks as instrument of poll and referendums which now seem to run freely out of any control or rule.

These measures may be a signal to a more likely civil society oriented world.

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