Introduction profits. foster and magdoff perspective of 2008

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Introduction

Credit crisis is a term that has been coined to describe the situation whereby accessibility of loans or credit finance becomes limited due to their unavailability. It is a trend that results to financial institutions reducing the amount of loans that they can disburse to clients irrespective of increased interest rates that they can charge on such loans (Turner).

Credit crisis is said to occur when the relationship between interest rates and credit loans being disbursed are heavily skewed, or when there is a general reduction of loans available in spite of increased demands. Ideally the relationship between interest rates and available financial credit is such that increased interest rate in the market means that financial institutions are willing to increase lending in order to increase profits.

Foster and Magdoff Perspective of 2008 Financial Crisis

Foster and Magdoff theory that attempts to explain the 2008 financial crisis attributes it to broader factors of monopoly finance capitalism which is a function of a phenomenon that they refer as stagnation which is a characteristic of mature capitalist systems. Generally credit crisis can be triggered by any of the various factors in the financial sector or combination of several such factors. There are mainly five reasons that directly affect financial institutions loans and which in extension can trigger a credit crisis. One of the reasons is anticipated fall in value of collateral assets that are used by creditors to obtain loans from banks (Graham 2008).

In this case the financial institutions become reluctant and unwilling to give out loans that are secured by such assets where all indications points to their

market values plummeting. Other reasons could be sudden exogenous adjustment in regulation by central bank that touches on lending requirements by banks or which elevates reserve requirements (Graham). The central bank might also trigger credit crunch through regulations that intend to tightly control financial institutions lending. In such instances the banks usually respond by enacting measures that prevent their loss or transfer their operating risks to the creditors usually through increased interest rates of loans or reduction in lending. However these factors alone cannot by their own trigger credit crunch, more often credit crisis is caused by an array of factors that combine together over a long duration of time. While Foster and Magdoff recognize these as causal factors that contributed to the 2008 financial crisis, they argue that by and large the major reason that greatly contributed to the financial meltdown was the stagnant nature of the current capitalist system. Foster and Magdoff describe mature capitalist system as “ stagnant” because of its monopolistic nature that is caused by few corporations that dominates and control most of the available capital flow (Fostor and Magdoff). When this happens as it has been taking place since the 1980s less capital becomes available for investment in economic sectors that are most in need while the real capital becomes restricted and unavailable, this outcome is what Foster and Magdoff also attributed to the occurrence of financialization.

The implication of this unbalanced excessive capital availability to particular players creates demands for investment opportunities that offer high returns; this is where the evils of monopoly-finance capital begin. The resulting scenario is massive injection of liquid capital in very questionable

investment initiatives which Foster and Magdoff says includes bankrolling of wars abroad as a way of investment at the expense of other sectors which are integral in economic growth. This form of capitalism is undesirable and dangerous according to Foster and Magdoff since it is unsustainable in the long run mainly because it ceases to become a “ freely competitive system” which is an underlying feature of all “ young capitalism” systems as described by Marx’s theory (Foster and Magdoff). Because all forms of mature economies eventually leads to stagnations which ultimately causes credit crisis, the system that mature capitalism has created is reliance on various financial bubbles that are designed to counter the problem of credit crunch but which ends up crumbling and therefore exposing the inherent weaknesses of this system. These financial bubbles are the final stages in a chain reaction process that is rooted in the monopolistic capitalist system that Foster and Magdoff attribute to the “ casino economy” because of the resulting effects that saw working class families loose trillions of US dollars in the aftermath of the financial crisis.

Causes of Financial Explosion

The hallmarks of a credit crunch usually include extensive sustained losses by lenders caused by sloppy and hasty lending policies over given period of time.

Sometimes it is due to plummeting of collateral assets that were used to secure loans which substantially lose value overnight as it happened to the United States housing industry. When this happens the bank sustains huge losses caused by loss in value of the assets. The implications that follow are two parts: the bank has no adequate loan reserve that they can continue

disbursing to future consumers, and two despite the availability of loans the banks becomes timid and cautious towards future lending. This becomes the early stages of a credit crisis since availability of loans get scarce and associated interest rates shoots up through the roof. The next phase of credit crisis is limited lending and inaccessibility of the loans by consumers and lack of funds in general that virtually affect every other sector of the economy triggering what is then referred as economic recession (Turner). However the effect of a credit crisis last for sometime only depending on the extent of loans that were disbursed by the banking industry and the extent in which the losses can be absorbed assuming the banks affected were not many. The global credit crisis that is just ebbing away has its roots in United States banking system, more specifically as a result of lending towards mortgage housing and credit lending in general.

The credit crisis did not only result to worldwide financial crisis but also caused slowed economic growth of the world’s largest and leading economy that eventually triggered global recession that started around as early as 2006 (Turner). In 2005 the United States housing industry flourished and reached its peak in terms of value and business bustle, by then the banking industry had aligned their lending funds towards this end as a result of the positive and sustained growth in the housing industry. By the time in what is now referred as housing bubble busted most banking institutions have invested significant amounts in the housing industry that had accumulated over time in a sort of loose credit lending.

The aftermath was increased mortgage payment defaults and foreclosures on existing loan repayment that was taking place on large scale. The other

cause is the amount of mortgage that borrowers had obtained that were purely for speculative purposes and therefore for investment only. By 2006 the number of mortgage and houses that had been secured as investment options were approximately 40% of all the total houses in the market (Turner). This was the main factor that greatly contributed to the housing surplus that made their price fall. Another cause was the securitization, a term that is used to describe a practice where bank can transfer the value of the mortgage to their investors and therefore continue to obtain further funds to lend to borrowers (Turner). Ideally the bank is supposed to hold on the mortgage as security until it is paid in full or forfeited, this way additional funds cannot be secured until such time when any of the two outcomes occur. However securitization system allowed banks to continue pumping funds to an already saturated sector while hoodwinking investors to believe housing industry to be thriving by transferring mortgage agreements to them.

In the process the banks were able to ease the lending terms and lower rates due to availability of funds in a bid to disperse as much funds as possible and therefore make profits. The lending conditions to borrowers were even questionable verging on illegal practices, figures released by Federal Reserve indicates that 47% of borrowers did not make any down payment of the mortgages as required by law (Turner). Over time borrowers were not required to provide evidence of income nor employment as should usually be the case, instead banks focus was on credit score which depended mainly on the amount that a borrower had in the bank beside other factors.

Limitation of Foster and Magdoff Analysis of Global Crisis

The analysis of the 2008 financial crisis in the book The Great Financial Crisis offers great comprehensive and in depth insight of the nature of the present monopoly capitalist system. To achieve this, the authors provide detailed analysis of various financial figures such as GDP, unemployment rates, income levels and so on that are very convincing.

However what this analysis lacks is a global perspective since almost the entire analysis is based on US economy; despite the fact that financial crisis originated from US economy a more broad analysis would have generalized this findings and explained the origin of financial crisis beyond the US perspective.

Works Cited

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