“Mere gambling transactions”

I sat down the other night to watch a DVD of one of the old Ealing studio comedies, ‘Kind Hearts And Coronets’. It was a break from all the feverish media reporting on the global financial crisis. Or so I thought. The film follows the success of Louis Mazzini (played by Dennis Price) in reclaiming what he considers his birthright. His mother was abandoned by the family for the crime of marrying an Italian of no social standing. He aims to murder his way to the title of Duke of D’Ascoyne, clearing his path of the individuals in the line ahead of him one by one.

Mazzini gets a job in the British bank owned by the D’Ascoynes. He becomes a partner when the head of the Bank loses his young son to an unfortunate boating accident executed, so to speak, by Mazzini. As the family line disappears by way of Mazzini’s endeavours as well as unfortunate accidents unrelated to his efforts, he is finally made a partner in the Bank.

One of the characters in the film comes in to renew his Bill or loan, having had a bit of a hiccup on the stock market. He say’s to Mazzini: “We sold short and the market hasn’t dropped as we expected.” Selling short, that rings a bell. Mazzini responds:

“We consider our function here to be the financing of constructive investment and not the financing of mere gambling transactions.”

“Mere gambling transactions”

Who would have expected a 1949 film to comment so succinctly on the 1985 global crash. But isn’t it here that one of roots of the current trauma lies? In place of constructive, or you might say productive investment (in the sense of being related to economic production – that old fashioned activity of making things and selling them) the global financial system has been turned into one in which “mere gambling transactions” have come to dominate.

Of course, it’s true that gambling has always been part of capitalism, but “investment” previously had more of a connection to economic activity in “the real economy”. However, the development of a global financial market has introduced a host of forms of gambling which are no more than a means of making money from money (or more accurately from pieces of paper) which was much more lucrative than real economic activity: easy money with quick returns.

At the heart of the current crisis lie ‘financial instruments’ which were supposed to express the innovative nature of the financial markets but which have helped to create the biggest crisis since the Great Crash of 1929. Securitisation, which by and large took the place of loans, grew on a massive scale. And it was the securitisation of housing debt which has brought the system to the brink. The decline in the US housing market and the growth of foreclosures created the ‘toxic’ debt which led to the ‘credit crunch’ since the banks took on much of this securitised debt in various forms. Nobody knows what they are worth since they comprise tranches of mortgage debt bundled together and sold on as investments, and passed on time and time again. Not so much pass the parcel as pass the parcel bomb.

Banks and financial institutions have been writing off billions of dollars of these securities. Estimates of these debts vary from $500 billion to a $One trillion, though they could be more. There are other forms of these exotic ‘financial instruments’, for instance, Credit Default Swaps.
BBC Reporter Robert Peston informs (I didn’t know it either) us that:

“Today is the beginning of “auction season”, when the International Swaps and Derivatives Association starts a series of auctions to settle who pays what to whom on a plethora of credit derivative contracts relating to businesses that have gone into default.

It’s settlement time on those humongous insurance policies for corporate debt, called credit default swaps, which I’ve mentioned to you as being another potentially lethal flaw in the financial economy.

In the coming three weeks, payouts of hundreds of billions of dollars may be made – or at least demanded – to cover losses arising from the defaults on the debt of Fannie Mae, Freddie Mac, Lehman and Washington Mutual.

Sandy Chen, the analyst at Panmure who's been a smart predictor of credit-crunch accidents, estimates that payments on Lehman's battered bonds could be as much as $350bn.

Now the problem here is that for every beneficiary of these payments, there's an underwriter – those who provided the CDS insurance – which has to find the cash. And, as I've pointed out, this was a largely unregulated market, so the great fear in markets is that some underwriters have insufficient capital and will simply collapse when the claims are made.

That in turn would hurt financial institutions expecting to be paid out on their CDS contracts and damage others with separate exposure to the collapsed businesses. The shock to the system could be very severe.

To compound the current anxiety about all this, the CDS market is so opaque that it's impossible to know right now who is holding the radioactive baby.

This gigantic CDS mess has contributed to the seizing up of money markets in recent weeks, the tendency of all banks and financial institutions to hoard cash – because no-one knows who or what may be vulnerable during the CDS auction season."

Call it radioactive baby or a version of pass the parcel bomb, isn't this the consequence of "mere gambling transactions"?

Martin Wicks
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