Messing with the Normal Rate of Return: A Discussion

Shimshon Bichler, DT Cochrane, Ulf Martin and Jonathan Nitzan
Jerusalem, Toronto, Hamburg and Montreal, July 2012

This discussion was previously posted on *Critical Mass*.

DT Cochrane
Toronto, July 11, 2012

I always find Matt Taibbi's writings on the crimes of the financiers very readable and occasionally funny, in a dark way.

http://www.rollingstone.com/politics/ne ... a-20120620

In this piece, he briefly mentions the Libor scam. I'm only just learning about it. But, from a CasP perspective, it would seem to point to a capacity among some members of dominant capital to differentially accumulate by messing with the normal rate of return. The article is mainly about the manipulation of interest-rate offerings for contracts to broker municipal bonds. These too could be considered a component of the NRR, although not quite as baseline as Libor. Thoughts?

Taibbi has more posts about the matter here: http://www.rollingstone.com/politics/blogs/taibblog.

Profit by Fiat
Shimshon Bichler & Jonathan Nitzan
Jerusalem and Montreal, July 20, 2012

The dogma. In his article, 'The Scam Wall Street Learned from the Mafia' (Rolling Stone, June 21, 2012), Matt Taibbi details the case of *United States of America v. Carollo, Goldberg and Grimm*. The case was over ten years in the making and concerns the rigging of public bids on municipal bonds, a market worth $3.7 trillion. The article reflects the liberal dogma, which Taibbi succinctly summarizes toward the end of his piece:

> That, ultimately, is what this case was about. Capitalism is a system for *determining objective value*. What these Wall Street criminals have created is an opposite system of *value by fiat*. Prices are not objectively determined by collisions of price information from all over the market, but instead are collectively negotiated in secret, then dictated from above (emphases added).

Translation. The market is natural and therefore objective and just (everyone is Pareto-Clark thankful for getting exactly what they deserve). Collusion is artificial and therefore subjective and unjust (the municipalities get less than they deserve, the banks get more, and the economy gets 'distorted'). From the viewpoint of capital as power, this claim makes no sense. There is no such thing as objective value. *All value is value by fiat*. And all value by fiat is value 'from above' – i.e., a reflection of a matrix of power (the capitalist *nomos*). In this sense, all the machinations on trial here sum up to one aspect of a much larger architecture of power and sabotage. The basic interest rate on which the fraud is superimposed is already a distillation of all the differential power processes in the world – which, together, form the normal rate of return. Indeed, the interest rate that emerges from the fraud is itself fed into that very normal rate of return. . . .

How does the scam work? According to Taibbi, the big banks (providers) collude with the auctioneers to divvy up the business between them and rip off the issuers (towns and cities). To illustrate: A municipality borrows money for a public project, say $10 million. The project is to last five years, and in the meantime the municipality wants to invest the money that is yet to be spent. The law requires the municipality to get competitive bids from at least three banks and choose the bank that offers the highest interest. The banks, however, collude to limit the competitive bidding. Every bank secretly retains its own set of auctioneers to whom it pays money (directly through bribes or indirectly through unrelated fees, other business, etc.). The auctioneer shows his retainer the highest offer he got from the other banks (allowing the bank to have the 'last look'). Knowing its competitors' bids, the bank in question ups its own offer by a few basis points (cents) above the highest bid, thus winning the auction. Everyone in the business participates in this game, as do the politicians who are bribed to look the other way.

This business reputedly started in the late 1990s. According to Taibbi, it is very much a case of Wall Street imitating the public-contract rigging practices of the Mafia (which in turn originated when the Mafia imitated the rigging practices of Rockefeller and his legions of acolytes). Nobody thinks much of this rigging. It is the way of doing business (as the Saudi oil minister Ali Al-Naimi once put it, 'the price is determined by the market, what we try to do is to make the market balanced . . . to get the market to the normal equilibrium and the price will take care of itself'). The defence's argument in the case was very much along those lines. This is a complicated business – certainly more complicated than fixing a car or a fridge – it argued; and just as we don't grill a good mechanic on every cent on his bill, there is no reason to do so with good bankers.

How big is the 'scam'? The most interesting question, though, remains unanswered: how much money has been scooped this way? Taibbi doesn't dare to estimate. But we can try to ballpark the annual numbers by multiplying the 'normal rig' – say 5 basis points, or 0.0005 – times the value of outstanding municipal bond – roughly $3.7 trillion in 2011. This multiplication yields about $1.85 billion in annual rigging profit on new and existing bonds. Now, according to Datastream, net banking profit in 2011 was $43 billion. Assuming an effective corporate tax rate of 20% implies about $54 billion in pretax profit. And since all profit is rigging of a sort – 'profit by fiat', to paraphrase Taibbi's terminology – we can estimate that, in 2011, *municipal rigging amounted to about 3.4% of total bank rigging.*

Objective Confusion: Contribution to a Silly Season's Discussion

Ulf Martin

Hamburg, July 27, 2012

Follow up on Matt Taibbi, 'The Scam Wall Street Learned From the Mafia' [Rolling Stone, 21 June 2012] and the reactions by DT Cochrane, 'Messing with the Normal Rate of Return' [Critical Mass, 11 July 2012] and Shimshon Bichler and Johnathan Nitzan, 'Profit by Fiat' [BNArchives, 20 July 2012].

Objective values. Some remarks in addition to Bichler/Nitzan's 'translation' of this quote from Taibbi:

> That, ultimately, is what this case was about. Capitalism is a system for determining objective value. What these Wall Street criminals have created is an opposite system of value by fiat. Prices are not objectively determined by collisions of price information from all over the market, but instead are collectively negotiated in secret, then dictated from above.

'Determining objective values'. What constitutes 'objectivity' in social affairs? Difficult topic [cf. Adorno et al., The Positivist Dispute]. In the natural ('positive') sciences, objectivity is arrived at by intersubjectively controllable observation that is then generalized into theories and, most importantly, the assumption that reality is not affected by the theories. For example, in their behaviour the Higgs bosons don't care about the theories of Mr. Higgs or anybody else. By contrast, making a statement about society may change what's going on. An economist told me at a conference that any theory about what's going on in the capitalist world fails to be differentially profitable once it becomes widespread. Society is inherently self-referential. And also, differential profit requires the non-sharing of relevant information (non-transparency).

Price setting is a quantification of this self-referentiality. Price setters observe what their competitors do and set prices such that they have a chance to accumulate differentially (or merely survive the capitalist power struggle, as the case may be). The situation would be different if there were an underlying objective reality which generated the prices in a regular way. Labour value theory and marginalism were attempts to theorize such a reality. They have failed. Thus, we have no theory of objective values in a sense that matches the meaning of the term in the positive sciences.

Taibbi explains the 'objective determination' of prices as resulting from 'collisions of price information from all over the market'. Apart from this being a quirky metaphor (how does a variety of information 'collide'?), the problem is that a set of price information is not objective just because different price setters publish different bids for the same kind of product, since each price was made up in secret by each of the price setters (possibly with reference to information already published).

Taibbi, along with all market ideologists, confuses objectivity with intersubjective self-referentiality.

Competition. Following the above quote, Taibbi cites a famous political commentator:

> 'One of the biggest lies in capitalism', says Eliot Spitzer, 'is that companies like competition. They don't. Nobody likes competition'.

Indeed, all capitalists try to monopolize their commodities. Many items that enter markets are already unique. For example, no two pieces of real estate (the most fundamental type of property) are strictly equal. Practices and institutions like intellectual property (trademarks, patents, copyrights), Apple Stores, OPEC, etc. are attempts to generate unique commodities. Even the grocery store next door is unique in that it is the only grocery store next door.

Now, if several capitalist entities collude to act as a single entity but pretend to be multiple price makers, this may be illegal. But the attempt to monopolize the product (here: services to public institutions) as such is standard practice.

Thus, all quiet on the capitalist front.

Certainly Taibbi is wrong to believe that if all the price setters were working independently, then we'd remove all caprice and achieve an objective price. However, we need to be careful with a claim that all value is set 'by fiat'. 'Fiat' has two somewhat opposed meanings. The first is 'decree' or 'authorization'. The second is 'arbitrary'. The meanings get compounded through a particularly common normative judgement about authoritative action. When governments or other powerful entities act in ways we don't like, we may dismiss their decisions as arbitrary. However, this is a dangerous perspective for the prospects of social science, as there is little means of studying or understanding arbitrary decision-making. Fortunately, decisions are rarely — if ever — made in this way. Rather, there is a great deal that informs and goes into making a decision. That's why I say the two meanings of 'fiat' are somewhat opposed. The authorizations of powerful entities are generally very much deliberate. We do ourselves a disservice if we dismiss those with power as lazy or stupid. The majority are anything but.

'Fiat' is derived from *facere*, which means 'to do' or 'to make'. When N&B tell us that, contrary to Taibbi's distinction, "*all value is value by fiat*," they're telling us that all prices are deliberately constructed. This directly contradicts mainstream theory, which treats prices as a revelation of the market. Recognizing prices as a construction does not mean that prices are not real any more than recognizing a house as a construction would mean it's not real. What it does mean is that there needs to be much more work done to understand how these prices are actually constructed.

We currently have a massive gap in our knowledge thanks to the obfuscatory claims of the 'law of supply and demand' and the presence of an 'invisible hand'. While Taibbi contributes to this obfuscation, he also does important journalistic work uncovering some of the actual machinations that go into creating these prices. N&B draw our attention to the fact that far from being a distortion, this process — which Ulf describes as one of 'inter-subjective self-referentiality' — is just one more concrete, explicitly constructive act by those in the finance industry.[1] However, much of the work involved in constructing these prices is unknown, or only known in small bits and pieces. Who is making the decisions involved? What process do they use? What tools and information are drawn upon? What gets consulted? Why that and not something else? This is why I'm personally interested in some of the ethnographic work being done by economic sociologists like Karin Knorr-Cetina and Urs Bruegger, the latter of whom is himself a former financier.[2]

One final caution: we shouldn't take this to excuse the crimes Taibbi describes. It could be easy to read into N&B's piece a claim that because all value is value by fiat, the acts described by Taibbi are no better or worse than 'business as usual'. However, this would be wrong. For Taibbi and other defenders of the market, normative judgement is dictated by how they believe markets function. Markets realize fair and efficient prices and are thereby good by definition. In reality, it's no normative position at all. Instead, it is an attempt to eschew actual social responsibility.[3] We can, and should, certainly critique

[1] Jonathan might correct me to say I mean 'finance business'. However, when it comes to financial intermediation, where the product is financial instruments, the distinction seems to break down.
[2] Karin Knorr Cetina and Urs Bruegger, 2002, 'Global Microstructures: The Virtual Societies of Financial Markets', *American Journal of Sociology*, 107(4): 905–950.
[3] In the language of Castoriadis, they construct a heteronomy. See Cornelius Castoriadis, 2007, 'Imaginary and Imagination at the Crossroads', in *Figures of the Thinkable*, Stanford University Press: 123-152, available at http://www.notbored.org/FTPK.pdf

the ‘business as usual’. However, we can also join Taibbi and other liberals in outrage at the crimes he describes for the costs they impose on the largely powerless masses. Although the crimes are not a deviation in their method, they are a deviation from a legally sanctioned process. The laws dictate a certain process for creating the interest rates for municipal bonds. Contrary to Taibbi and other liberal defenders of the market, this process is not a means to enable the virtues of the market. Instead, it is a means to bound the process of price construction. We need not join in the deification of markets to prefer a process of interest setting for municipal bonds that keeps certain information from the finance industry bidders. However, we can also go further than Taibbi. Once we acknowledge that both the criminal and the legal processes are constructed, we can recognize the role for society in dictating what the process looks like. In fact, we can acknowledge the role for society in dictating all price-construction processes. Unfortunately, at the moment our ideology of ‘the market’, to which Taibbi contributes, occults the constructive process, reserving it for a tiny, powerful minority.