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Contracting the Commonwealth: John R. Commons and Neoliberal Financial Crises

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This essay adapts Commons's model of the legal foundations of capitalism to the peculiar circumstances of the neoliberal era. So doing provides a lens for seeing clearly the steady erosion of state capacity to protect the commonwealth, even in a nation with a hegemonic currency. Our focus here is on the links between the "triple crisis" of the 1980s and the subprime and foreclosure crisis of the 2000s. We show how Brady bonds, after being used to resolve the Latin American debt crisis in the 1980s, provided a governing contractual context for subprime lending – and as such constrained the capacity of the American government to respond to a crisis that preyed on the vulnerable, undercut community life, and contracted the commonwealth.

Keywords: John R. Commons, commonwealth, subprime and foreclosure crisis, Brady bonds, financial crisis, neoliberal era, securitization

JEL: B15, B25, B52, G01, G18, H10

Why have economists paid so little attention to the consequences of financial crises? Financial forces are pressuring sovereign governments worldwide to privilege the needs of globally mobile capital over any efforts to restore the welfare of their citizens, even the vulnerable. In the United States, a strangely invisible foreclosure crisis — along with substantial fiscal strain on many cities and towns — has followed the subprime meltdown. In Europe, the suffering of those without shelter or medical care, and the plight of the jobless young, have been largely ignored in the post-crisis period. Lest this inattention seem callous, we can note that it has become par for the course in a neoliberal era of deregulation, privatization, and reduced public services. How many economists paid any attention to the "lost decade" that followed the 1982 Latin American debt crisis? It has become normal to view sovereign governments as bearing ultimate responsibility for economic crises. National governments can, at best, not impede national economies' efficient adjustments to shocks. Those who lost homes should not have been able to buy them. Those dependent on the state for their survival should not be. Those without jobs are victims of an insufficiently flexible labor market.

In *Legal Foundations of Capitalism* (1924), John R. Commons's focus on the sovereign state's central role in overseeing market transactions provides a definitive corrective to this neoliberal approach. Market processes are seen as historically specific and institutionally embedded, not autonomous. National law defines the nature and limits of the transactions that

define the rights, duties, liberties, and exposures to risk of the parties participating therein. This structures the hierarchy of rights and obligations in the economic realm. In this vision, government is not a *deus ex machina* operating outside the logic of the market. Instead, the sovereign state, and its courts of law, define the very substance of market exchange in the context of the society's governing constitution.

The limits to permissible transactions, in turn, help to shape the "working rules" of the "going concerns" — the households, firms, and states — that undertake economic activities. In Commons's vision, the sovereign nation and its courts decide on what economic transactions are permissible by considering whether they serve any public interest, and, specifically, whether they protect or enhance the commonwealth of the people of the nation. The idea of the commonwealth, for which the state is responsible, provides an ethical (and legal) reference point for evaluating the (societal) gains or losses from letting any set of economic processes go forward.

Commons's institutionalist approach then emphasizes the core role of the sovereign state in guiding the people who depend on it through whatever challenges they collectively confront. Seen through this lens, the neoliberal view of the state as a source of shocks or adjustment inefficiencies is itself the product of the crises that have beset capitalist economies in the past several decades. Neoliberal-era crises that have put the meaning of sovereignty itself into question can be seen as calling forth a renewal of sovereign power, not its further decimation. The 1980s "triple crisis," the 2007–2008 U.S. subprime mortgage crisis, and the subsequent Eurozone crisis, have all forced sequential shifts in the rights, duties, liberties, and exposure to risk of all the agents involved, directly or indirectly: lenders and borrowers, banks and wealth-owners, nation states, and these nation states' citizens and residents. These shifts have expanded the freedom of action — the liberties — of lenders and wealth-owners and banks, while reducing the rights and assets of vulnerable households and the communities in which they reside. Shifting legal and economic practices, linked to power asymmetries, have forced sovereigns to focus on preserving orderly financial markets and on protecting the legal rights of the owners of claims on abstract cash flow. From a Commons perspective, states that should be protecting the commonwealth of their citizens have been forced to contract it. From a neoliberal perspective, states' contracting role in the governance of market allocations is in accordance with natural economic order.

This essay adapts Commons's model of the legal foundations of capitalism to the peculiar circumstances of the neoliberal era. So doing provides a lens for seeing clearly the steady erosion of state capacity to protect the commonwealth, even in a nation with a hegemonic currency. Our focus here is on the links between the "triple crisis" of the 1980s and the subprime mortgage crisis of the 2000s. We show how Brady bonds, after being used to resolve the Latin American debt in the 1980s, provided a governing contractual context for subprime lending, and as such constrained the capacity of the American government to respond to a crisis that preyed on the vulnerable, undercut community life, and contracted the commonwealth.

Commons on the Economy, Commonwealth, and Finance

In *Legal Foundations of Capitalism*, Commons begins his analysis by making a key distinction —

for our consideration of global finance — between real economic activity and the reduction of that activity to an abstraction. One of his examples is between the sum of value of a business's assets and its status as a "going concern."[1] While classical and neoclassical economic theories are concerned with the former problem, Commons focuses on the tension between the two. As he succinctly puts it, "[e]conomic theory began with a Commodity as its ultimate scientific unit, then shifted to a Feeling, in order to explain a Transaction which is its practical problem" (Commons 1924, 5).

His rationale arises from his historically informed institutionalism:

> Starting … with individuals rather than the working rules of going concerns, [reversed] the historical and the causal sequence … the inference is that the working rules were designed by a rational being for the protection of the preexisting rights and liberties of individuals. But, as a matter of fact, the notion of individual rights is historically many thousands of years subsequent to the full development of working rules … [which] are designed primarily to keep the peace and promote collective action and only secondarily to protect rights and liberties. (Commons 1924, 137)

Commons's interest centers on societies in which virtually all wealth takes the form of privately owned or state-managed property. He asserts that transactions define economic behavior in any epoch. All activity of any going concern begins and ends with the purchase or sale of goods or services, and this concern's working rules must conform to the rules, obligations, and rights arising from the transactions it undertakes. Transactions are shaped by systems of law. The Anglo-American countries use the "common-law method of making law by the decision of disputes" (Commons 1931, 651). If disputes arise, parties that cannot agree will turn to the courts to organize sanctions. The U.S. Supreme Court thus sits at the apex of the economy. It declares constitutional what it finds to be reasonable. Commons derives his theory of institutional economics from the decisions of the Supreme Court. "[T]he economists went off on theories of happiness, but courts and lawyers continued on the theory of the common law of England and America" (Commons 1936, 237). For Commons, then, economic theory has to be based on the relationship of "man to man," not "man to nature." But it is "reasonable value," not "labor value" or "utility" that can ground institutional economics as the field of "measurable rights, duties, liberties, and exposures to the liberties of others" (Commons 1936, 242).

"Reasonable value" does not arise from any individual's view, but instead derives from "the Court's decision of what is reasonable as between plaintiff and defendant. It is objective, measurable in money, and compulsory" (Commons 1936, 244). "Hence it is not theories that must be obeyed; it is decisions … the decision is a fiat of sovereignty" (Commons 1936, 245). The court decisions of this sovereign define what is fair, and generate space in which willing buyers and sellers can find one another. These decisions also structure rules of four kinds, which delimit the actions of individuals and of going concerns: "a rule of compulsion, or *duty* … [then one that defines] what the individual *can* do … it is a rule of authorization, or *right* … [a third defining] what he *cannot* do ... [it leaves him] in a condition of *exposure* or danger … [and, lastly, a rule that] tells what he *may* do … it is a rule of permission, that is, *liberty* …" (Commons 1924, 147-148).

Commons sees "three types of persons, the citizen, the private concern, and the state" (Commons 1924, 150).[2] Each, as a going concern, "is more than an entity, it is collective action … it is the working rules that decide the disputes and keep the mass together in support of the rules" (Commons 1924, 152). So, institutional economics is a "nationalist theory of value," a "collective action in control of individual action" (Commons 1936, 246). The nation is defined as a public, which collectively possesses and nurtures the nation's wealth:

> The public is not any particular individual, it is a classification of activities in the body politic deemed to be of value to the rest of the public, rather than a classification of individuals. Anyone who comes along "indifferently," and gets himself into a position where he might perform that class of activity, is the public. His private interests, when he gets in that position, are deemed identical with the public interest. (Commons 1924, 329)

It is apparent that Commons views the economy neither through the lens of class conflict or owner-manager conflict. His hope, embedded in his analytics, is that every member of the public can add to the value of goods and services exchanged, thus earning their just desserts and contributing to "the mass together in support of the rules." He introduces the distinction between wealth and commonwealth, with the latter term representing the sum of the citizens' private concerns and the state's wealth. It is the nation's asset, to which all should contribute: "The basic principle of the commonwealth … [was] Let any person get rich in so far as he enriches the commonwealth, but not insofar as he merely extracts private wealth from the commonwealth" (Commons, 1924, 227).

What can disturb this harmony of interests is the exercise of power. The "power to withhold opportunities is economic power, and associated power is government" (Commons 1924, 320). In an extended discussion (Commons 1924, chapter 2), Commons contrasts power and opportunity, and argues that when economic power is used to extract an extra margin from others, then the income earned does not expand the commonwealth. Such power must be restrained by the courts (the "associated power"), even though it reduces the liberty of those firms or individuals so as to maximize opportunity. In effect, those who have positional power, in Commons's view, must be induced to focus on activities that increase the commonwealth instead of on activities that restrict the opportunities of less advantageously placed agents.

Commons on the Regulation of Banking and Finance

Commons does not directly discuss the problem of power in finance in *Legal Foundations*, owing largely to his chosen analytical schema. He argues that Western economies have passed sequentially through three stages: (i) an agricultural stage, based on landlord and tenant relations; (ii) a commercial stage, based on the creditor and debtor; and (iii) an industrial stage, based on employer and employee. He does analyze credit in a 1937 essay that intervenes in a debate about aspects of John Maynard Keynes's *General Theory* (1936). Commons criticizes the argument that the economic system can achieve reequilibration through downward-flexible prices and a passive set of adjustments facilitated by the banking system. This idea of the economy as a self-adjusting machine contrasts with Commons's insistence on viewing the

economy as a nexus of contracts. He attacks the passive role that many economists assign to credit in economic analysis. He observes that credit is not a "flow": "it is an active joint creation by contracts of credits and debits to be liquidated by payments" (Commons 1937, 685).

Commons approvingly cites Keynes's (1936, 81) remark that it is an "optical illusion" that the two acts of saving and credit are one. He writes: "This is a two sided transaction of buyer and seller, made possible by the legal invention of negotiability of debts," and these are "active" elements of the economy, for which "[f]orecasts of time are of their essence" (Commons 1937, 685-686). Commons comments that the active view he shares with Keynes has rightfully led to the strict regulation of finance:

> Credit regulation in America has already reached into almost every detail of the private banking business. No other business man is entitled to complain more strenuously than the banker against government interference. This public control is coming to be more or less guided with reference to its effects on the general levels of securities and commodity prices. (Commons 1937, 689-690)

Taking a "laissez-faire" approach will end, he writes, in "a rather pathetic appeal to big business voluntarily to reduce prices. The pure logic of the argument is inescapable. … Apparently in all fields the business men must actively be taught their own business by government through compulsory school attendance. This education includes the field of credit regulation" (Commons 1937, 692). Here, we see Commons clearly applying the institutionalist logic of *Legal Foundations*: Namely, economic theory that ignores the core characteristics of the really existing economy leads to self-deception and public policies destructive to the commonwealth. Writing three years after the Franklin Delano Roosevelt's 100-day New Deal reforms, Commons's description of "public control" of banking implies his concern over banks' abuse of their economic power. Yet, he does not elaborate.

National Power, Supranational Power, Community, Household

Commons's analysis allows us to analyze finance and crises rooted in credit market breakdowns from the perspective of the interest of the nation in building its commonwealth and in suppressing excessive economic power through the power of its courts. To adapt his argument for our purpose, we must extend it in two directions.

First, Commons does not touch on the problem of supranational economic power. He argues that sovereign powers, once they have established rights in property in a nation, can expand either by "conquest or purchase." "By international treaties it opens up opportunities and enforces the bargains of its citizens in all parts of the world. By military preparedness and defense it perpetuates these conquests, purchases, and penetrations" (Commons 1924, 386). He terms the latter — "political expansion," in contrast to "political economy" — the economic relations of the nation as it is. In effect, he does not anticipate any legal power superior to the nation-state, which is any transactions that the laws of the state cannot shape in protection of its commonwealth.

Overlooked here is the global expansion of financial relations, across borders, by firms that resist national control and, yet, have the capacity to inflict great losses on the nations that

charter them. Commons would not be surprised that the worldwide spread of contractual claims on securitized loans and on contingent claims in spot, futures, and derivatives markets could expose nations and their commonwealths to great risk. What would alarm him is the view that the nation must admit to a superior legal power in using its courts to protect its citizens' interests.

Second, we need to extend Commons's notion of "going concern" to two additional economic units: the community and the household. Commons's list of "persons" includes the individual, the firm, and the (national) state. This reflects perhaps the great historical sweep of *Legal Foundations*, as well as the profound events of the day in which he wrote. However, it is logical to apply the idea of "going concern" to cities, towns, and neighborhoods, as these are structured entities that support the nexus of wealth generation on which Commons's attention focuses. And we shift from Commons's "individual" to the "household" at the micro-level, making explicit the gendered social relations that constitute day-to-day life. Note that because they slash cash flows, and thus threaten social roles and everyday survival, financial crises clearly undercut economic resilience and compromise "going concerns" at various scales.

The "Triple Financial Crisis" of the 1980s

In considering financial crises, economists tend to focus on their causes — on how faulty market mechanisms could lead arms-length contracts to fail — and especially, as Carmen Reinhart and Kenneth Rogoff (2013) note, on the causes of sovereign debt crises that involve borrowing in foreign currency. Little attention is paid to the consequences of financial crises. But it is precisely these consequences — the institutional developments that unfold after the outbreak of crisis — that constitute our focal point here.[3]

The U.S. banking system in the post-war period, and through the 1970s, was both tightly controlled (as per Commons's 1937 comment in the previous section) and economically functional. That is, most financial transactions were undertaken by insured depository institutions, and they largely provided credit that supported business activity and home purchases without excessive losses. The banking system did fall short in meeting the financial needs of the commonwealth (taken as a whole) in its widespread use of racial covenants and discriminatory practices, which left residents in minority communities with restricted access to working capital loans, capital, and homeownership (Chiong 2014; Dymski 2006; Hernandez 2009). The passage of the Civil Rights Act in 1964 and of two 1970s federal acts, mandating community reinvestment, did increase access to credit in these excluded communities, but to a limited extent.

However, before the benefits of this controlled system of finance could be shared with all members of the U.S. commonwealth, it was thrown into a triple crisis in the early 1980s. High rates of price inflation, combined with two successive recessions and unprecedentedly high interest rates, led to a crisis in the housing-finance system. The U.S. system for the provision of home-purchase loans, and for home-loan refinancing, relied on a nation-wide system of savings and loan associations and savings banks (thrifts). These institutions' business model consisted of making and holding long-term mortgages that were supported by local savings deposits. As interest rates spiked, households pulled their savings into money-market funds. Thrifts had to borrow funds in the money markets to cover mortgage loan portfolios locked into much lower

interest rates. The thrifts were either insolvent or illiquid or both. Hasty deregulation at the federal and state levels led to speculative lending in some states and to runs on thrifts in two states (Ohio and Maryland) in 1985.

The second two elements of the triple crisis were intertwined. Money-center banks had been seeking to expand their market shares since the 1960s, but, by the late 1970s, these banks had lost many of their larger borrowers to direct credit markets. The dramatic rise of oil prices in that decade pointed to the rosy prospects of developing-market economies with substantial resources. Most of the money-center banks led lending consortia that competed to expand lending in Latin America. One, Continental Illinois of Chicago, focused its attention on Penn Square Bank in Oklahoma, with over $1 billion loan participations in the U.S. "oil patch" states of Oklahoma, Louisiana, and Texas. In 1982, falling oil prices and spiking interest rates burst the "oil patch" states' bubbles. This led to the July failure of Penn Square Bank and Mexico's August default in 1982. By the end of the same year, a sovereign debt crisis had spread to six Latin American nations.

The resolution of this triple crisis involved two deviations from Commons's vision of governance of the national commonwealth. The first was triggered when the Federal Deposit Insurance Corporation (FDIC) provided temporary assistance to Continental Illinois after this bank experienced an electronic bank-run in May 1984. The FDIC intervened under an "Open Bank Assistance" (OBA) provision that permitted it to assist insolvent banks, whose continued existence was "essential" to maintaining adequate banking services in the community. The OBA mechanism had been used for the first time in the 1970s, when assistance was rendered to banks in inner-city communities. Those OBA interventions can be understood, in Commons's terminology, as means of insuring that all individuals have full access (in this case, through the credit market) to opportunities that can add to the commonwealth.

This provision was then used in 1980 to assist the 23rd largest U.S. bank, First Pennsylvania Bank. Since no Pennsylvania bank was large enough to acquire this bank — and since strict prohibition against inter-state bank acquisitions were in place — OBA intervention was justified on the basis that it would prevent disruptions in the regional and national banking market. The OBA provision was then used fourteen times in the 1981–1983 period, and ninety-eight more times in the 1987–1988 period (the peak years of insolvency problems for commercial banks). In effect, the rationale for OBA intervention was expanded to include the avoidance of market disruptions. Government powers could be used to maintain the systemic integrity of the financial system.

On May 11, 1984, two days after the Continental Illinois bank-run, Continental borrowed $3.6 billion at the reserve window of the Chicago Federal Reserve Bank. Sixteen large banks (led by Morgan Guaranty) supplemented this with a $5 billion line of credit on May 14 the same year. A buyer that would step in and end this interim arrangement was sought, but not found. The obvious solution was liquidation. But Continental, chartered in Illinois — a "one-branch" state — depended heavily on borrowed funds provided by foreign wealth holders and large domestic banks. Liquidation, by imposing losses on liability-holders across the globe, would threaten large U.S. banks already weakened by the Latin American debt crisis. Liquidation imposing losses on global liability holders would threaten their access to overseas borrowed funds markets.

On September 19, 1984, Comptroller of the Currency, C.T. Conover, testified before

Congress that eleven banks had become "too big to fail." He explained: "Had Continental failed and been treated in a way in which depositors and creditors were not made whole, we could very well have seen a national, if not an international, financial crisis, the dimensions of which were difficult to imagine" (Conover 1984, 288). The next day, a *Wall Street Journal* article (Carrington 1984) named the eleven banks. Six days later, a resolution for Continental was announced.

Creating a "too big to fail" category of large banks restricted the federal government's capacity to insure that these corporate persons' actions enhanced the national commonwealth. These entities would be protected as "going concerns" even when precipitous actions they undertook, because of their size and reach, subtracted wealth from the commonwealth. This protection began to recognize a power "higher" than the nation: global financial markets. In 1989, this led to a second contravention of Commons's vision: the creation of Brady bonds with fiscal supports organized by the federal government.

After the 1982 Latin American defaults, several rounds of rolling over the unpaid debt had come to naught. Since the large U.S. banks involved had outstanding unpaid loans that were more than double their capital levels, this constituted a Damoclean sword hanging over the heart of the U.S. banking system. By 1986, some fifteen countries had had debt problems. The then Treasury Secretary, James Baker, proposed new rounds of bank- and international financial institution lending to these countries. The Baker Plan failed, largely because of collective action problems that emerged among creditors. While it was in all creditors' interest to resolve the debt non-payment problems, any particular resolution might not be in any individual bank's interest. Given the diverse characteristics of the creditors involved, and the contracts they had signed, problems in negotiating as a group and in "free-riding" blocked progress toward a universally acceptable solution (Spiegel 1996).

Lee C. Buchheit, among other analysts, framed these problems in a way that has shaped the subsequent terrain of globalized lending.[4] Buchheit pointed out that the long-held belief in a "community of interest among bankers" regarding what was then called bank "loan sub-participations" had been badly shaken. After "the Penn Square Bank failure, bankers seem less eager to presume a level of competence and straightforwardness on the part of their fellow bankers" (Buchheit 1986, 150), a situation only exacerbated by the recent round of sovereign debt restructurings. "These worries were present even in 'innocent' days of this market. In practice, these traditional problems recur with a frequency that is sufficient to make their oversight by lawyers hazardous" (Buchheit 1986, 151).

A Commons solution was ruled out by the murky terrain of "conflict-of-laws" (Gruson 1988). Resolving such a conflict requires a finding by one nation's court that the interests of the parties over which it has coverage are more vitally at stake than those of other parties, with the concurrence of all the other national courts involved. This would be unlikely in any one case, and, if achieved, unlikely to rule out future conflicts, given the diversity of contracts and parties involved. This is problematic in that "[c]ertainty and predictability in contract law and satisfying the reasonable and legitimate expectations of the parties as reflected in their agreement are the primary desires of parties entering into commercial agreements" (Gruson 1988, 561).

Buchheit observed: "If ever there was a time for ingenuity and creativity in managing the so-called 'debt crisis,' now is the time. The conventional remedy … has already been exhausted for many debtor countries. Absent sensible alternative remedies, the possibility of outright

default or debt repudiation increases dramatically" (Buchheit1988a, 399). He argued that while events may generate conditions for a "global solution," it would be wise to "deliberately limit [discussion] to the tactical, rather than the strategic, aspects of the problem" (Buchheit1988a, 371).

Lee C. Buchheit and Ralph Reisner (1988) describe as a "fairy tale" a situation before a judicial tribunal where an advocate for a party involved in a sovereign debt restructuring addresses their remarks. "To the International Banking Community":

> For example, the hundreds or thousands of credits that purport to be covered by a restructuring request will have been separately negotiated between borrowers (both public and private sector) and individual banks or, in some cases, "syndicates" of banks' lending pursuant to a single loan agreement. These banks, located in countries all over the world, are subject to differing regulatory and disclosure regimes, and have distinct lending and credit review policies and widely divergent practices in important areas such as loan loss reserve provisioning. (Buchheit and Reisner 1988, 493)

So, the international banking community has been forced into "a rather uneasy confederation":

> The enormity and complexity of sovereign debt problems preclude individual banks from negotiating adjustments to their own credit exposure in isolation from fellow lenders. Unanimous participation by the banking community in these affairs, however, was thought achievable only if very strict assurances could be given that all similarly situated lenders would be treated equally. The banking community pursued the goal of equal treatment by incorporating into restructuring agreements certain contractual provisions that, in their original form, were designed to regulate the behavior and status of various lenders to a particular borrower. In the restructuring context, however, these provisions are significantly expanded in an effort to regulate the behavior and status of all commercial bank lenders to all borrowers in a debtor country. (Buchheit and Reisner 1988, 494)

The authors emphasize that "patterns of accepted inter-creditor behavior in these circumstances have evolved without any statutory or regulatory guidelines for reorganizing the financial affairs of a sovereign borrower comparable to domestic bankruptcy or insolvency laws. What has happened, therefore, has happened only through a consensus among the participants, without the benefit of any outside policy-making authority or enforcement mechanism" (Buchheit and Reisner 1988, 494). In conclusion:

> The effect of the sovereign debt crisis on inter-creditor relationships has been dramatic and rapid. The international banking community has learned to act as a more or less unitary creditor group. The international banking community has also devised methods to suppress anxieties regarding preferential treatment of certain individual banks, encourage unanimous participation in exercises that are by their nature unanimously unpopular, and discipline those members of the community who may show tendencies

toward unacceptably unilateral behavior. (Buchheit and Reisner 1988, 516)

It remained to be seen whether "a residual tendency toward collective behavior" (Buchheit and Reisner 1988, 517) would persist after the current round of problems was resolved. The international bankers were agreed, however, that "credit agreements should reflect the banks' entitlement to regard themselves as lenders to the country as a whole, not just separate borrowers within the country" (Buchheit and Reisner 1988, 517).

This discourse provided the context within which Brady bonds were created in March 1989 for thirteen nations embroiled in the 1980s sovereign-debt crisis. Banks unloaded their sovereign loans, converting them into bonds they continued to hold or sell off to other investors. Individual contracts were then structured for those carrying on as creditors of existing claims. The U.S. Treasury provided thirty-year zero-coupon bonds as collateral in many cases, with borrower countries purchasing these bonds with International Monetary Fund (IMF) and World Bank financing, or with their own reserves. In some cases, payment was guaranteed by double-AA securities held at the Federal Reserve Bank of New York. The diverse resolutions available eliminated the "holdout" problem. While the formal Brady process ended in the 1990s, the mechanisms and conventions created for this program have been carried on after the Brady program had officially ended.[5]

The recruitment of the Federal Reserve to the cause of underwriting banks' strategic needs was not restricted to the Brady bond incident. In 1998, the Federal Reserve preapproved the impending merger of Citibank and Travelers Group, giving the parties an eighteen-month-window within which the passage of a law removing the Glass-Steagall prohibition of the intermixing of commercial and investment banking would be required. The Gramm-Bliley-Leach (or Financial Services Modernization) Act of 1999 provided the necessary legal change. Insofar as financial deregulation and consolidation had been on the national policy agenda since 1980, the Federal Reserve's action was understandable, if not admirable. Less forgivable has been the Federal Reserve's passivity regarding subprime lending, discussed below.

Some further analysis of these two threads of 1980s' triple crisis is warranted before we move on to the subprime mortgage crisis, which emerged from the resolution of the third thread. It is immediately clear that Brady bonds "solved" an otherwise unresolvable collective action problem thrown up by conflicts of law in the international sphere. It was a resolution by non-solution, following a long legal tradition (Bechheit, Gulati and Mody 2002). But its price was the further dilution of the place of the nation-state as envisioned in Commons's commonwealth idea. While Brady contracts were agreed separately, they were feasible because of the validation of the power over global finance — hence over the legal authority of the nation-state — of what Buchheit called a "unitary creditor group." Further, the U.S. banks most involved in this workout were precisely those defined as "too big to fail" in 1984. Ironically, creating a feasible solution required this group's coordination outside of the umbrella of law, and outside of the sphere of the lawyers, as (lawyer) Buchheit acerbically pointed out.

This gave these banks — if not a cabal, then a motivated interest group — the freedom to manage what has been an unmanageable problem from the viewpoint of every nation's interest in preserving (if not enhancing) its own commonwealth. The contractual lock-ins rooted in the original loan agreements from the 1970s and 1980s, and the possibility of "holdout" problems, make impossible any clean and universal solution of a "one size fits all" variety.

Bankers generate a mutually advantageous outcome by acting as a single interest on the "lenders' side of the table" in negotiations with individual borrowers that actually cannot be resolved. They avoid any joint-action cabal by borrowers — that is, any systematic effort to undo the complexity of deals made in the past with a single write-down bargain. They also avoid the prospect of continual renegotiations carrying forward into the future. With the Brady bond solutions, the deals have all been cut, and these will end only in debt repayment or debt repudiation. The "certainty" that was indicated as so necessary in the height of the crisis was achieved.

The principles laid down in the Brady bond outcome — bankers' unity in constituting a distinct interest; the opacity of the deals that banks make to preserve the integrity of the financial relationships they have constructed; the priority given to private negotiations between parties and counterparties in globalized financial markets over and above the interests of the citizens and non-financial businesses in nations whose financial representatives may be parties or counterparties — are of crucial importance. These principles define an approach to the coexistence of global finance and nation states that subjects Commons's national commonwealths to the prior claims of what is evidently a higher power in the neoliberal era — international markets.

Subprime Lending as a Brady Bond Solution

The thrift crisis led to further financial deregulation and to the construction of an almost fully securitization-based — and eventually much riskier — system of housing finance.[6] Mortgage companies took the lead. Initially, they focused on packaging "plain vanilla" loan offers that FNMA and FHLMC were willing to underwrite and sell off on the mortgage-backed securities (MBS) market.[7] Deregulation permitted the creation of new savings vehicles, such as private equity and hedge funds, many of which focused on high-return investments. The growth of private market underwriting and the 1994 invention of credit default swaps permitted mortgage companies to offer riskier mortgages, with higher rates, trigger clauses, and higher fees and penalties than "plain vanilla" instruments. The market centralized, and the volume of subprime loans and other forms of predatory lending exploded as the financial markets (at the hub of which were the surviving "too big to fail" megabanks) expanded the scope and depth of the markets for mortgage (and non-mortgage) securitization. The plentiful liquidity available to Wall Street encouraged megabanks to increase their leverage and off-balance sheet positions. A range of new derivatives markets based on real or synthetic securities provided expanded opportunities for zero-sum speculation.

This brings us to a third development that eroded Commons's nation-state-as-protector-of-the-commonwealth framework in this period. As described in detail elsewhere (Dymski 2006; Hernandez 2009), it was no secret that the subprime and predatory lending emerging in the 1990s often corroded the welfare of individuals and households, especially in lower-income and minority communities. A number of state-level initiatives, aimed at the worst lending market abuses, were blocked by federal courts because they contravened the U.S. Constitution's interstate commerce clause. The U.S. Congress remedied this by passing the Home Ownership and Equity Protection Act of 1994. However, the Federal Reserve, under Alan Greenspan, refused to promulgate regulations implementing the provisions of this act giving the Federal

Reserve the authority to "prohibit unfair or deceptive lending" on the basis that the purposes of this Act were not clear (Dymski 2011a). This provision was implemented by his successor, Ben Bernanke — and then only on a limited class of loans — in July 2008 (McCoy, Pavlov and Wachter 2009, 500-501). The collapse of the subprime market, already in motion, brought down the U.S. financial system two months later.

However unclear the legislative intent to penalize or reduce predatory lending may be, chairman Greenspan need only have looked more carefully at the implications of continuing developments in overseas borrowing markets. The sovereign debt market continued to grow explosively, even though — as Buchheit (1999) pointed out — the rights and duties of creditors and debtors remain undefined, and bond buyers tend to be even less well-informed than bankers about underlying risks. All this suggested that a "new financial architecture" for global finance was needed. Buchheit observed that while this had been "talked about at extraordinary length for the last two years," "it is not yet clear how many concrete changes the official sector will insist upon and the private sector will accept" (Buchheit 1999, 229).[8]

But financial markets were not biding their time until that new architecture was in place. To the contrary, while the Brady bonds represented — from Buchheit's point of view — a set of idiosyncratic and unique solutions to evolving real-world governmental dilemmas, the markets found a way to normalize these idiosyncratic deals. As, In-Mee Baek, Arindam Bandopadhyaya, and Chan Du (2005) show, a "stripped yield spread" can be generated for these bonds, permitting a calculation of "the market's" assessment of their risk.[9] According to Gergana Jostova (2006), there were $100 billion in Brady bonds outstanding in 2001, and trading volume on these instruments was $1 trillion in 1993 and $2.7 trillion in 1996. Baek, Bandopadhyaya, and Du (2005) reported $200 billion outstanding in 2005. The extensive trading permits position-taking on the basis of this terrain of risk/return combinations.[10] JP Morgan provides a daily estimate of stripped yield spread.

What has gone almost entirely unnoticed in the analysis of both sovereign debt and the subprime market are the close parallels between the two. These parallels are difficult to see because one of the key moments in subprime lending — and, in fact, in virtually all over-the-counter securitization — is the disconnect between the original borrower-lender relationships and the investor-seller relationships that supersede them as claims in the globalized financial sphere. Let us spell out the parallels:

- First, the many tranches of lenders, with unique relationships to the debt as originally issued
- Second, the different nationalities of the owners of this debt; the fact that this debt is owned by wealth-owners across the world, subject to different national rules
- Third, the opacity of the debt contracts being traded
- Fourth, the use of credit default swaps (CDSs) to transfer risk from lenders to counterparties
- Fifth, the lack of reliance on debt "cram-downs" when debt repayment became problematic

By 2006, 46 percent of all mortgages were originated in the private label market. First, unlike MBS, backed by FNMA or FHLMC, they were "heterogeneous in their terms," making "trading in private label securities difficult and illiquid, with the consequence that rating agencies, not markets, assessed the risk of private label MBS." Second, FNMA and FHLMC

guaranteed credit risk of the securities they issued, so these securities were not "priced or tranched for that risk" (McCoy, Pavlov and Wachter 2009, 496-497). Senior tranches were treated as risk-free, and junior tranches as risky. And, as default risk rose, the overall rates of interest offered to investors did not increase: that is, senior tranches were not reclassified as risky. Steven L. Schwarcz (2008) puts it differently, blaming dependence on agency rates on "complexity." The prospectus in a typical offering of subprime securities was hundreds of pages long, which "made the risks very difficult to understand" (Schwarcz 2008, 1110). Further, by contrast with the case of corporate securities, originators of securitized paper have a fiduciary duty to investors in that paper, but no such duty exists in the case of special purpose vehicle securities.

Subprime Lending and the Double "Double Helix" of Counterparty Obligations

These similarities make it clear that the instrumental design of subprime mortgages and their rapid spread across global financial markets owed much to prior experience with MBS and Brady bonds.[11] At the same time, there are three critically important differences. The first two led uniquely (and as they did not in the case of Brady bonds) to what can be called a double "double helix" of counterparty obligations.

The first difference — and the first "double helix" — involves payment obligations on the debt obligation itself. In the case of sovereign debt, the owners directly hold the debt of borrowers (countries, in some cases formerly companies). In the case of subprime debt, the owners hold obligations owed to them by banks, which themselves were/are lenders to borrowers who may or may not be able to perform. Most Brady bonds have their origins in debt contracts involving third parties in the borrower country. But since the point of origination of these bonds (those specifically authorized under the Brady plan) involves a sovereign debt crisis, the sovereign nation effectively underwriting the original transaction (or taking on the obligation) is effectively the only debtor in the relationship.

Before the subprime securities markets soured, the opacity of these instruments was interpreted as a sign of these markets' efficiency (Oldfield 2000). The very opacity of subprime lending is something carried over from the Brady bonds. The difference is that, whereas the Brady bonds were created in the context of the archaeology of years of prior contracts, the subprime securitizations *started out* that way. They were complex, multiparty, opaque, and unwindable *by design*. They constitute a non-negotiable demand on the resources of the nation state by "lenders"/investors who have agreed to terms and contracts with the megabanks that retailed these bundled loans. The "original borrowers" and the communities in which those borrowers live (or once lived) are not part of that game.

This leads to the second "double helix" of counterparty obligations. CDSs had been used, successfully (Skinner and Nuri 2007), in the Brady bonds markets to price risk.[12] However, CDSs grew out of control in the MBS market. These instruments were unregulated due to heavy lobbying by representatives of the financial industry. They were excluded from securities regulation in the 1999 Gramm-Bliley Leach Act, and given a blanket exemption from commodities regulation (and thus from being exchange-traded) in the 2000 Commodities Exchange Act. Investment banks that in many cases were bundling and selling private label MBS, also "bundled CDS into offerings of synthetic CDOs [collateralized debt obligations, one

version of which is an MBS], which sought to track the returns on regular CDOs. … By 2008, the total notional amount of CDS outstanding totaled anywhere from $43 to $66 *trillion*, vastly more than the debts that they insured" (McCoy *et al.* 2009, 527-528).

Consequently, CDSs "magnified risk instead of hedging it" inasmuch as they "create daisy chains of counterparty liability, whereby one buyer relies on the solvency of its seller to cover the buyer's own CDS exposure to another buyer down the chain" (McCoy, Pavlov and Wac*hter* 2009, 529). So in effect, subprime securities gave rise to risk that was insured on the original payment contract, and traded in the market as a CDS. But they also permitted the creation of additional CDSs based on an unregulated synthetic CDO market. As Patricia A. McCoy, Andrey D. Pavlov, and Susan M. Wachter (2009) note, the problem arises because these obligations are traded over the counter, so the buyer is not aware of how much total CDS exposure the seller has assumed.

Subprime Resolutions and the Expendability of Subnational "Going Concerns"

The third difference between Brady bonds and subprime loans begins with a similarity. As noted above, "cramdown" solutions, wherein the original parties to the debt could reset the volume of debt to reflect a payable sum consistent with the post-crisis realities those parties faced, were ruled out. In the case of Brady bonds, the federal government stepped in to provide Treasury securities, when necessary, to underwrite some borrowers' ability to pay. As the seizure of foreign assets was not feasible, the government thus provided some sweeteners so as to protect the nation's megabanks' interests.

"Cramdowns" were also ruled out in resolving unpayable subprime loans. However, there was no question of the federal government encouraging mortgage renegotiations, bolstering mortgagees' collateral with pledges of Treasury securities. For, this time, banks were on the other side of the transaction. So many home loans were underwater that such pledges would involve a huge — and politically untenable — increase in federal debt. Furthermore, permitting the mortgagees to shift from the debt payments, which had been promised to those that were feasible, would not solve banks' fundamental problems with underwater loans. This problem involved the "double helix" mentioned above. Banks had made binding business contracts with purchasers of bundled subprime mortgages. These contracts' obligations did not depend on the status of the underlying mortgages, but rather on the terms and conditions negotiated between the buyers and sellers of these securities. The holders of these securities would come after the banks that had sold them this bundled credit irrespective of events in the housing markets. Hence, rather than permitting "cramdowns," and setting a precedent that would increase market uncertainty over bank viability, banks insisted on repayment or on repossession of the mortgaged property, except in those rare instances where the federal government's subprime relief programs did actually permit borrowers to stay in their homes. What resulted was a flood of foreclosures, totaling twelve million across the country.

While the federal government made some efforts to relieve the pressure on distressed homeowners, the U.S. government was more fundamentally committed to preserving the viability of its financial system, given that system's near meltdown in September-November 2008. As in the 1980s crisis, this meant stabilizing the system, maintaining U.S. institutions' access to overseas borrowing markets, and creating a return pathway to solvency for "too big

to fail" banks. While no final tally is available, the subsidies extended to megabanks via public equity infusions, quantitative easing, and Federal Reserve purchases of mortgage-backed (and other) securities (usually at par) dwarfs the expenditure of public funds on distressed borrowers with subprime loans.

This is the point at which the notion of communities and households as "going concerns" comes into play in our argument. Commons's "going concerns" are all multi-person, spatially defined entities characterized by dense internal (as well as external) exchanges of goods and services, income and investment flows, emotion, knowledge, tradition, and so on. We suggested above that this term should be extended to cities, neighborhoods, and households. Insofar as they persist through time, these entities create and reproduce distinct cultures. And the persistence and interaction of these entities *as* going concerns, at different scales, provides the micro- and macro-social structures of human communities. Various hierarchical dependencies emerge. Most households depend in some measure on the existence of neighborhoods, cities, as well as nation states. Commons did not articulate his concept in hierarchical terms, but the existence of micro-to-macro dependent linkages, with the sovereign state leading and looking after the welfare of all the other levels, can be clearly seen.

The sovereign's Supreme Court decisions about what constitutes value — meaning, what transactions are permissible, what constitutes fair exchange, and so on — can be understood as interventions that sustain and resolve conflicts between the intra-national "going concerns" at different levels, all in the national interest. This changes when "conflicts of laws" considerations introduce extra-national considerations and interests into Commons's equation. For once, maintaining a stable financial system (or viable megabanking sector) requires compliance with demands posed by global financial interests, in which case any nation's Supreme Court loses its status as an adjudicator of value for the nation state it serves. The application of its laws is subject to a higher power.

This is, of course, where the "double helix" character of subprime securitization becomes determining. For the prior demands made by global financial interests compromise the national state's options, and require that it support the interests of its "too big to fail" banks. In the case of the subprime mortgage crisis, the immediate consequence may be foreclosure. If so, this destroys the link between household and home. In this event, the household may stay together as a unit, even in the same geographic location, but its characteristics as a "going concern" are likely to be dramatically altered. It will no longer be paying property taxes, and perhaps sales and income taxes, to the local units of government where its now forsaken home is located. This, in turn, means that the sub-national governmental units hosting this home — the city and county governments, the school districts, and so on — will all lose tax revenues. When foreclosed properties are hyper-concentrated, the revenue losses can be extreme, and the incremental expenditure costs generated by extensive foreclosures can be high. In consequence, the sovereign nation that takes what it perceives as necessary measures to preserve the stability of its financial system, in the context of the subprime crisis, is undermining the "going concern" viability of the local units of government that comprise its very governmental micro-structure.

Conclusion: Reviving Commons's Logic in the Post-Crisis World

Some of Commons's ideas about state, market, and community have been applied here to the circumstances of the neoliberal era. We began by showing how the 1980s "triple crisis" (Latin American debt crisis, U.S. savings-and-loan crisis, and meltdown of Continental Illinois) illuminated the threats that a deregulating financial sector with global reach poses for economic stability and national prosperity. We adapted Commons's model of capitalism to account for globalizing financial capital by contrasting the roles of a hegemonic, money-center sovereign (the U.S.) with that of non-hegemonic Latin American nations under IMF oversight. In particular, Brady bonds embody the way in which globalized and systematically important financial firms have structured transactions in ways that undercut the key function of the sovereign as the guardian of the commonwealth. Force — and not just liberty and duty with respect to the commonwealth — emerged as a factor in structuring the terrain of transactions.

The contractual form of the transactions that dominated in the subprime lending spree routinely violated Commons's criteria, and illustrated the implications of permitting an unregulated, hyper-competing, speculation-oriented financial sector to operate without adequate sovereign oversight. The resulting crisis was resolved, as in the 1980s, with reaffirmation of the subjection of the nation state's fisc and powers to its megabanking sector. Consequently, the commonwealth shrank and the vulnerable suffered lost homes and broken communities. As a result, former subprime hot-spots, such as California's Central Valley and Inland Empire, have been the backdrop for banks' navigation of a new set of profit-making opportunities. The loan modification "sweat box" phenomenon, the eminent domain issue, and bulk sales of REOs come to mind as examples of how the purposive lack of legal direction and banks' ability to resist fair enforcement standards have permitted them to make profit even in the chaotic environments their reckless lending has left behind. The deleterious effects of the subprime mortgage crisis on communities as "going concerns" have been overlooked. The fact that this extended crisis has not led to a social explosion can be attributed to the fact that it occurred decades after neoliberalism had begun to shift agents' expectation parameters and sovereign governments' provision of public services.

This argument clearly has implications for the crisis of the European Monetary Union (Eurozone). The Eurozone's structure, and the adjustments that its Maastricht and Lisbon treaties mandated, represents a further step toward the restructuring of the role of the sovereign under neoliberalism. The national state is not understood in these treaties as an independent source of decision-making power validated by democratic votes. It is, instead, simply an instrument for effectuating market discipline when evolving macro-circumstances require that national consumption, investment, and/or government expenditure be shrunk.

This reflection on the interaction between financial globalization, the sovereignty of the nation state, and communities as "going concerns" leads to several conclusions. One is that financial globalization, when linked to the prerogatives of "too big to fail" megabanks, displaces the nation state from the central role that Commons envisioned for it in the structure of economic activity: namely, that of organizing the hierarchical flows of transactions among the "going concerns" which comprise any vibrant society's lifeblood. A second conclusion is that the potential fragility of modern banking systems in the era of globalization can push the maintenance of financial stability itself to a prerogative for the use of the nation state's power. This goal displacement will carry a heavy political price insofar as it reduces the capacity of national governments to provide safety-net protection for their populations. Third, the inability

of sovereign states in the EMU to determine their own monetary policies, and to set their own fiscal policies, removes them even further from Commons's ideal of the sovereign as protector of a public commonwealth. To the contrary, some nation states are unable to protect their public's commonwealth, while other nation states are insisting that these losses be borne for the good of the whole. Here, the contradictions between political coherence and political economic necessity can be seen very starkly through the lens of Commons's historical conception of capitalism.

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Footnotes-to-be

[1] This insight anticipates Michael C. Jensen and William H. Meckling (1976) by 52 years. However, whereas Jensen and Meckling conclude that business structures should be manipulated so as to maximize the flow of monetary value to owners, Commons views the firm holistically as a "going concern."

[2] He also distinguishes between the state and government: "The state is but one of many going concerns … The 'government' … is the series of transactions going on between officials and the citizens" (Commons 1924, 149-150).

[3] One of the present paper's authors (Dymski 2011b) reviews the theoretical literature on the causes of neoliberal-era financial crises.

[4] Buchheit, a partner at Cleary Gottleib, remains a key litigator and negotiator in the Eurozone crisis (Moulds 2013).

[5] Brady bonds accounted for 61 percent of all emerging-market debt trading in 1994, though only for 2.0 percent in 2005 (EMTA 2014). Mexico retired its Brady bonds in 2003, Brazil in 2006.

[6] A 1980 banking deregulation act and a 1982 mortgage deregulation act "dismantled the existing prohibitions against a variety of risky loan features, such as non-amortizing mortgages, negative amortization mortgages, balloon clauses, and other interest rate structures creating high potential payment shock" (McCoy, Pavlov and Wachter 2009, 501).

[7] A mortgage loan is "plain vanilla" when it is adequately collateralized (so that the loan on the property financed does not exceed 80 percent of that property's market value), when loan servicing takes a modest share of residents' income (usually a third or less), and when there are no other encumbrances on the property. The Federal National Mortgage Association (FNMA , or Fannie Mae) and the Federal Home Loan Mortgage Association (FHLMC , or Freddie Mac) also had maximum loan amounts which varied over time.

[8] Joshua Aizenman (2002) also warned of the dangers of a hasty plunge into financial opening, especially for emerging market countries.

[9] The authors succinctly summarize the procedure: "These bonds are denominated in U.S. dollars and the principal and a part of interest are collateralized with U.S. treasury bonds. When evaluating a Brady bond, it is necessary to 'strip' the principal and interest guarantees in order to extract a comparable sovereign risk premium that is assessed by the market on the issuing country. Brady bond stripped yield spread is then the difference between the Brady bond stripped yield and the U.S. treasury bond yield with a similar maturity" (Baek, Bandopadhyaya and Du 2005, 540).

[10] Indeed, Gergana Jostova (2006, 527) finds that Brady credit spreads for U.S. investors are double what they should be, an "[i]nefficiency [that] results from the restrictions of a nontransparent, institutionally dominated, dealer market and the lack of a fully developed derivatives market for emerging country credit risk."

[11] Also critical was the chronic U.S. current account deficit, hence its systematic capital account inflows which persisted during the entire neoliberal era.

[12] Initially, the credit risk of Brady bonds was priced on a Brady bonds futures market that was traded on the Chicago Commodities Futures Exchange. However, a CDS market based on MBS had successfully replaced an MBS futures instrument as a vehicle for pricing risk in the early 1990s (Nofthaft, Lekkas and Wang 1995). Consequently, the emergence of CDSs for MBS led Brady bonds traders to switch to CDSs for Brady bonds, as CDSs have outperformed futures

markets in pricing Brady bond risk. The result was the cessation of Brady futures trading in 2001 (Skinner and Nuri 2007).