

THE SUBPRIME CRISIS AND GLOBAL FINANCE: A SOCIOLOGICAL PERSPECTIVE

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Keywords: Subprime lending, Mortgage loans, Housing market, Emerging markets, Global finance, Financial innovation, Securitization

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Summary

The most recent set of innovations which have been introduced into the global financial situation involve the securitization of debt, in particular through mortgages and other aspects of debt. The first section examines the question of housing mortgages for low- and moderate-income households as a new target population for global finance, a target that is now viable given new innovations in mortgage finance. The second section examines the large dynamic of financial deepening and what it tells us both about the potential growth in emerging markets and the potential for using residential mortgages as one vehicle. The third section makes a micro-level incursion to get at the question of who are the prime targets of subprime lenders. The focus is on New York City and on Washington DC. The final section examines the question of spread of costs and strategies. While this innovation started in the U.S., it has spread to other countries. Global banks have paid a price, but they are also the most aggressive actors in introducing residential financing in emerging markets.

1. Introduction

The financial deepening of economies has become one of the major dynamics characterizing advanced economies. The ratio of global financial assets to global gross domestic product was nearly 350 percent in 2006, a ratio that jumps to 450 percent in a growing number of highly developed countries, from the U.S. to Japan. More generally, the number of countries where financial assets exceed the value of their gross national product more than doubled from thirty-three in 1990 to seventy-two in 2006. Securitizing a broad range of types of debt is a key vehicle for this financial deepening. Government and corporate debt have been subjected to securitization for several decades, with variable degrees of success. The extension of securitization into consumer

debt, including mortgages, took off in the 1980s in the U.S. Thus mortgage securitizing is not new; indeed, the first mortgage-backed security was invented in 1977, though not necessarily widely used at the time.

While mortgage securitization is not new, the current phase is an innovation that could play a critical role in the financial deepening of countries worldwide. What marks this innovation is the extension of securitization to subprime mortgages and to mortgages for low- and moderate-income households. This feature takes the option of a mortgage well beyond the most advanced economies and the middle- and high-income classes.

There are three aspects of this financial innovation that are at the heart of the thesis developed here:

1. The target population is vast, especially when globally linked financial markets facilitate the deployment of these instruments in a rapidly growing number of countries. India and China, but also Eastern Europe, have underdeveloped mortgage markets but rapidly growing middle classes, a prime combination for introducing this innovation. In many emerging economies it is foreign banks and financial services that are developing the mortgage markets.
2. The character of the innovation rests in good part on speeding up the numbers of mortgages granted and their bundling in order to reach the necessary thresholds for sale in the capital markets. This changes the logic for granting a mortgage: the velocity of mortgage-bundling becomes more important than the credit-worthiness of mortgage grantees.
3. The low levels of financial deepening in many countries signal a large potential for the marketing of these mortgage instruments. From the perspective of finance, one measure of this potential development is the ratio of outstanding residential mortgage debt (that is to say, mortgage capital) to GDP in highly developed economies, e.g. seventy percent in the U.S., but about ten percent in both India and China.

For moderate- and low-income households, investment in housing can be conceived of as a mechanism for concentrating whatever the small resources such households can command. What they have available beyond basic needs will go into securing housing. Thus a financial instrument that allows low and moderate-income households to acquire a mortgage becomes a vehicle for extracting those funds, bundling them up into a financial instrument, and selling them in the capital markets. It also becomes a potentially powerful vehicle for the financial deepening of economies, especially in so-called emerging market economies.

These particular types of mortgage-backed securities have the potential to deliver profits to wholesale finance, to devastate the savings of modest-income households and to lead to macro-crises. The potential for profits is vast, insofar as there are massive numbers of such modest households, and the aim is large numbers for bundling and then selling off rather than long-term investment. The potential for devastating household losses is also vast, as seen with the sharp jump in 2005 to 2006 in home foreclosures among low- and modest-income households under these new types of mortgages; foreclosures are

expected to reach their highest point in 2010 to 2011. Finally, the potential for macro-level crises is unexpectedly strong, though partial, as indicated by the subprime mortgage crisis that exploded in 2007. Given the globality and interconnection of financial markets, when something goes wrong with the new mortgage-backed securities in one country, the spillover effects can be massive and go well beyond the originating country. For instance, the loss of market value of subprime securities just since early 2007 totaled around \$380 billion in March 2008.

The use of subprime and of low- and moderate-income residential mortgages to develop new types of securities represents a new frontier for wholesale finance. It is not just that it represents yet another source of profits. It becomes one instrument to expand the residential mortgage market in advanced economies and to introduce mortgages into less developed economies with large numbers of low-income households. It is the beginning of a micro-financial history that gets wired into foundational structures of whole economies. Housing is a sector that cuts across social classes; across the different spaces that constitute an economy, from rural to urban; and across almost all major industries through the housing construction and furnishing phases.

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Biographical Sketch

Saskia Sassen is the Robert S. Lynd Professor of Sociology and a Member, The Committee on Global Thought at Columbia University. She is also a Centennial Visiting Professor at the London School of Economics.

Her research and writing focuses on globalization (including social, economic and political dimensions), immigration, global cities (including cities and terrorism), the new networked technologies, and changes within the liberal state that result from current transnational conditions.

Her three major books have each sought to demolish a key established “truth.” Thus in her first book, *The Mobility of Labor and Capital* (Cambridge University Press 1988), she showed how foreign investment in less developed countries can actually raise the likelihood of emigration. In her second book *The Global City* (Princeton University Press 1991; 2nd ed. 2002) she showed how the global economy, far from being placeless, has and needs very specific territorial insertions, and that this need is sharpest in the case of highly globalized and electronic sectors such as finance. In her most recent book, *Territory, Authority, Rights: From Medieval to Global Assemblages* (Princeton University Press 2006; updated ed. 2008), she shows that the foundational transformations afoot today take place largely inside core and thick national environments; this allows her to explain that some of the changes inside liberal states, most evident in the USA but also increasingly in other countries, are not distortions or anomalies, but are the result of these foundational transformations inside the state apparatus. She shows how this foundational transformation hence consists not only of globalizing dynamics but also of denationalizing dynamics: we are seeing the formation of multiple, often highly specialized, assemblages of bits of territory, authority and rights that were once ensconced in national framings. Today these assemblages traverse global and national settings, thereby denationalizing what was historically constructed as national.

Sassen is also the author of *A Sociology of Globalization* (Norton 2007), *Cities in a World Economy* (3rd ed. Sage/Pine Forge 2006), the “Sustainable Urban Settlements” theme of this Encyclopedia, the edited *Deciphering the Global: Its Spaces, Scales, and Subjects* (Routledge 2006), and the co-edited *Digital Formations: New Architectures for Global Order* (Princeton University Press 2005).