Gloomy, With a Chance of Depression

by Doug Henwood, editor of
Left Business Observer

When things get slow here at RQ, we like to pull out our monthly copy of Left Business Observer and take turns doing dramatic readings, savoring the 8-page newsletter's pithy, incisive analysis of the global economy.

No one is better at making Economics accessible than LBO editor Doug Henwood, who also has a popular show on public radio.

This article was written in late 2008, at the height of the recent financial crisis. Henwood weaves the collapse and subsequent bailout into a cautiously optimistic vision of a more equitable future.

See end of article for more on Left Business Observer.

I have often described the U.S. economy by invoking the old Timex watch slogan from the 1950s, "Takes a licking and keeps on ticking." Crash follows upon panic follows upon bust, and yet the thing keeps getting up again to binge some more.

These remarkable feats of renewal, though, have always come with big help from the U.S. government, either multibillion dollar bailouts or long rounds of indulgent monetary policy from the Federal Reserve. But revive it always has, despite the forecasts from the hard left and the hard right that this time it was different and the medicine just won't work.

Will it work again? Will the megadoses of stimulus do the trick?

Or is the jig up? Will what's widely touted as the greatest financial crisis since the 1930s be a prelude to Great Depression II?

Backstory

Before proceeding, a little reminder of how we got to this sorry pass. People borrowed gobs of money to buy houses they couldn't afford, and then borrowed additional gobs against the rising value of those houses. All that borrowing was the result of a toxic mix of misplaced optimism, outright fraud, and quotidian necessity.

But that's not all. Wall Street, which can never let well enough alone, enabled all this mad borrowing in at least two ways. The first was securitization — packaging multiple mortgages into bonds, which were then sold to institutional investors, thereby bringing forth a cornucopia of funds for further lending.

Second, they also packaged mortgages, from solid to rocky, into a raft of synthetic securities that hid the full extent of the risks from people who should have known better — the professional money managers who bought all those wacky derivatives that have now blown up. And a lot of those money managers were operating with borrowed money, often large quantities of it.

The last two paragraphs make an essential economic point. Some progressive pundits and politicians have argued that any government bailout should be aimed at debtors, not banks.

It would be nice if we had that choice. But sadly, the history of financial crises shows that speed of response is crucial, and since it will take a long time to sift through several million upside-down mortgages, the wobbly financial superstructure has to take precedence — in time, not importance.

The official response to crisis

Two International Monetary Fund (IMF) economists, Luc Laevan and Fabian Valencia, [in] a historical database of 124 banking crises around the world since 1970, show that some sort of systemic restructuring is a key component of almost every banking crisis, meaning forced closures, mergers, and nationalizations.

Shareholders frequently lose money in systemic restructuring, often lots of it, and are even forced to inject fresh capital.

The creation of management vehicles to buy up and eventually sell distressed assets (either financial assets

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like loans or real ones like strip malls or housing tracts) is a frequent feature of restructurings, but such schemes do not appear to be terribly successful.

More successful are recapitalizations using public money — meaning that the government injects funds into the banks in exchange for stock. Such stock is usually sold off, often at a profit, when the banks return to health, though of course a government with socialization on its mind could keep it.

Laevan and Valencia also find that relief for troubled debtors [such as those with distressed mortgages] also helps an economy get out of a financial crisis. This is a nice coincidence of economic efficiency and social justice.

Those who don't want to spend taxpayer money should consider this: Laevan and Valencia suggest that what you save on bailout expenditures you more than lose in a deeper recession.

Bailout Politics

The original bailout proposal was ludicrous — all 840 words of it. But the House initially rejected their own improved product. Most of the opposition came from the Republican right, though some of the more leftish Democrats helped out.

Republican complaints were delusional. One of the leaders of the right flank of the anti-bailout camp, Jeb Hensarling of Texas, said that the rescue plan would lead the U.S. down "the road to socialism."

If only.

If the right opposition was delusional, the left opposition flirted with the juvenile. There were some hyperradicals who wanted no bailout because they want the whole system to come crashing down. That's not politics—that's nihilism.

But less exuberant sorts also said some troublesome things. "We" shouldn't be handing money over to Wall Street — instead we should be spending it on schools and green jobs.

Yes, it would be lovely to spend lots of money on schools and green jobs. But it wouldn't address the financial crisis. A busted credit system is a very serious problem for everyone, not just the bourgeoisie.

It is absolutely essential that this not happen. One of the things that made the Depression of the 1930s so bad was the collapse of 10,000 banks between 1929 and 1932. Savings were wiped out, and the machinery of credit creation, which provides an essential nutrient for the real economy (it's not all "speculation," though it may look that way sometimes), seized up.

Fed chair Ben Bernanke has been extremely active in trying to prevent a rerun [including lowering basic interest rates to nearly zero, where they remain in mid-2010].

But the Fed can't do it alone; saving the banks requires the expenditure of real money.

No banks, no economy.

Debt Relief and Regulation

But the solution — the "bailout" — has been far from perfect.

Let's look at how we might do better — first in the "realistic" sense, fully aware of the constraints of American politics, and then in a more fanciful sense, of what we might do to make this a better world.

Debtors must be relieved. This isn't only a matter of social justice, it's good orthodox economics. With all the complexities of securitization, this is easier said than done, but that's no excuse for not doing it.

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And finance must be re-regulated. It's reasonable that it wasn't considered in the bailout. Figuring out how to regulate this massively complicated financial system is no easy matter. But it's got to be done.

Finance has gotten so complex and internationalized that it would take lots of time and negotiation even to get a start on things. The old Bretton Woods system, established at the end of World War II, was based on a world of fixed exchange rates, tight capital controls, and unchallenged U.S. dominance.

Now exchange rates float, capital moves more freely than people, and the U.S., while mighty, is hardly unrivalled.

That rivalry is no longer just about Western Europe and Japan — there are also what Wall Street calls the BRICs: Brazil, Russia, India, China. Just for starters. It's difficult to see how a group of countries with different systems and interests can allow regulation to work.

Troubling Questions

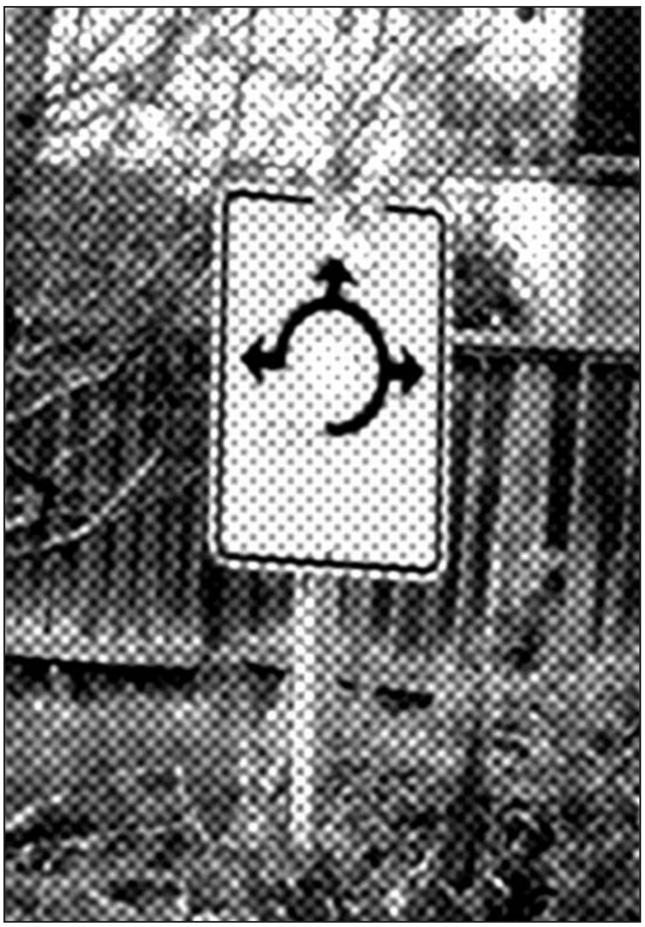
What kind of regulation should the global Left call for? Is the point to make the system work better, in the sense of being less crisis-prone and more humane?

Or is the point to renovate the whole thing? Could a wholesale renovation happen without the existing order collapsing or being torn down? Would we want to throw several hundred million out of work with the vague hope of making things better?

Just who is this Left anyway, and what power do we have? Is our constituency the poorest of the world, to whom the financial system means next to nothing, or the middle ranks who have something but are always at risk of losing it, or the more enlightened elements of the bourgeoisie? All three?

Or is it just idle wankery to dream that "we" have any influence, or that such a "we" even exists?

Waxing more utopian, you can take that further and say that banking is rather like an old-style utility — something so essential to all of us that it should be regulated like electricity used to be before the preposterous experiment with utility deregulation.



If the government is bailing out and nationalizing banks and other financial intermediaries, why not keep some of them in the public sector [ie, retain government ownership "for the common good"]?

Why not use [these institutions] to fund real economic development in neighborhoods starved for capital? Why not extend low-cost financial services to poor people who are now fleeced by check-cashing services and payday lenders?

We can dream, can't we?

Contradictions

It must be admitted that the [Obama] stimulus program looks half decent in both size and content. Infrastructure spending, green energy, and aid to state and local governments are all good things, and will have a salutary economic effect, too.

But there are some contradictions to consider.

One is financing. Almost everyone assumes that the U.S. will have little trouble raising hundreds of billions for its bailout and stimulus schemes. What if it finds selling all those bonds a little rough? Could the U.S. someday be perceived as a credit risk [such as Greece in 2010], only much bigger?

But there are deeper contradictions. Much of the restoration in corporate profitability from the early 1980s through the late 1990s — a trend that sagged in the early 2000s, then returned, though not as magnificently as before — came from squeezing labor — wage cutting, union busting, outsourcing, and the rest of the familiar story.

What wage incomes couldn't support got a lift from borrowing — credit cards first, then mortgages. The credit outlet is now shut, and will be for quite a while, forcing consumption

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to depend on wage income, which is shrinking. Capital will want to squeeze labor harder to restore profitability, but consumption won't have credit to help it out.

You could argue that this is exactly what the U.S. needs in orthodox terms: to invest more and consume less. Investing more means directing more cash into things and certain kinds of people (engineers rather than brand consultants) and less into Wall Street's pockets (which ultimately means the American rich).

This is a very different economic model from what we've been used to. It's probably not what a working class that has experienced 35 years of flat-to-declining real wages wants to hear.

A more humane way to go about reducing consumption would be taxing rich people, who still have lots of money. Some of it could be given to the less rich, and other of it to funding the bailout and stimulus programs.

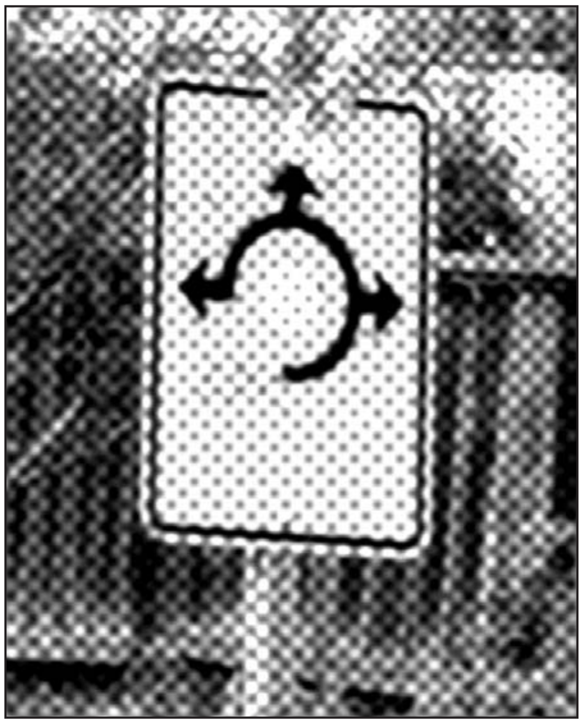
That's not in our present politics, but politics could change.

Political sequelae

There's a lot of talk about how this crisis marks the end of the neoliberal era, which it may be, and also portends the return of the state, which is a little more complicated.

Neoliberalism, a word that's more popular in the outside world than in the U.S., took hold in the early 1980s. Its most prominent feature is an almost religious faith in the efficiency of unregulated markets. The ideal is — was? — to make the real world resemble the financial markets as much as possible, with continuous trading at constantly updated prices, with allegedly self-regulating markets determining the allocation of both money and stuff. To do that requires the commodification of everything, including water and air. Much of that agenda was successfully accomplished.

Though it fantasizes itself to be antistatist, neoliberalism was nonetheless accomplished only with a heavy hand of the state. It could not have happened had the Federal Reserve [around 1980] not raised interest rates towards 20%, producing a savage recession that scared labor into submission and drove the world's debtor countries into the arms of the IMF.



It could not have happened if the IMF hadn't forcibly supervised the innumerable rounds of austerity, privatization, and market openings that were the "solution" to the debt crisis. It couldn't have survived without the repeated state bailouts that rescued the financial system whenever it hit a wall.

Now the financial system has hit a giant wall. While the world's states will probably succeed in preventing total disaster, there looks to be something end-of-the-lineish about this wall. Even very conventional people on Wall Street are talking about "the crisis of an economic paradigm," and the dawn of a "new Democratic era."

But these Democrats — who are basically what David Smeck calls "hedge fund Democrats" — don't have anything matching the transformative agenda that Reagan (a real movement conservative) did.

From that, it's possible to see a new Progressivism that would owe as much to Teddy Roosevelt as Franklin. But both those Roosevelt eras were shaped by radical agitation as much as elite reconstitution. We have little of that now.

Many people who voted [in 2008] for "Change!" are instead getting a slicked up version of the status quo. That's likely to lead to some disappointment — a potentially productive disappointment. The sense of possibility that Barack Obama has awakened is a very dangerous thing.

Back in the [1980s], the anti-communist Right loved to quote Tocqueville, saying that the riskiest time for a bad regime is when it starts to reform itself.

That's where our regime is right now, and it's a good time for us, whoever we are exactly, to go out and make it riskier.

It's going to get easier to win recruits as the ranks of the disappointed swell.

Doug Henwood is editor of Left Business Observer, an extraordinary 8-page newsletter published about ten times per year. Subscriptions are $22 per year.

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