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Lining Up for the Wall Street Gravy Train

By Mike Whitney
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British economist John Maynard Keynes, believed in capitalism, but he was also sharply critical of its structural flaws. He summed it up succinctly like this:

> "Our analysis shows… that long-run development is not inherent in the capitalist economy. Thus, specific 'development factors' are required to sustain a long-run upward movement."

What Keynes was alluding to is the fact that mature capitalist economies tend towards stagnation. What happens, is that the rate of return on investment begins to dwindle as overcapacity builds. That causes declining profits which lead to belt-tightening, rising unemployment and falling demand. As investment drops off further, growth slows correspondingly and the economy dips into a protracted slump. This corrosive stagnation is the challenge that all advanced capitalist economies face. The solution–as Keynes notes–lies in "specific development factors", which in today's terms means "financial innovations".

Financial innovation, like derivatives contracts and securitization, have created vast new opportunities for investment and profitmaking. This complex netherworld of highly-leveraged debt-instruments and off-balance sheet operations, constitutes a shadow economy where the process of capital accumulation persists despite pervasive inertia in the underlying economy. This is why the Fed and the Treasury have been doing their best to stitch the system back together without changing its basic structure. The same is true of Congress, which has gone to great lengths to preserve the profit-generating instruments which brought the global financial system to the brink of disaster. This is from the Wall Street Journal:

> "Lobbying by Wall Street has blunted efforts to step up regulation on derivatives trading by carving out exceptions or leaving the status quo in place. Derivatives took blame for some of the worst debacles of the financial crisis. But a year after regulators and critics began calling for an overhaul in the way they are traded, some efforts have been shelved and others have been watered down.
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> The two main issues concerning regulators were trading and clearing of swaps, which allow investors to bet on or hedge movements in currencies, interest rates and many other things. Swaps generally trade privately, leaving competitors and regulators in the dark about the scope of their risks. In November 2008, the chairman of the Senate Agriculture Committee proposed forcing all derivatives trading onto exchanges, where their prices could be publicly disclosed and margin requirements imposed to insure that participants could make good on their market bets.

> But a financial-overhaul bill passed by the House of Representatives on Dec. 11 watered down or eliminated these requirements. The measure still allows for voice brokering and allows dealers to use alternatives to public exchanges." ("How Overhauling Derivatives Died" Randall Smith and Sarah Lynch, WSJ)

"Voice brokering" is Wall Street parlance for making a deal over the phone. It makes a joke out of the anemic regulations passed into law by congressmen who are essentially agents of Wall Street.

The bottom line is that financial institutions will not be forced to trade trillions of dollars of derivatives on public exchanges where margin requirements would protect taxpayers against potential losses. Instead, Congress has given Wall Street the green light to continue selling products that are insufficiently capitalized so they can keep raking in gigantic profits. That means it's only a matter of time before another one of the financial giants keels over from its bad bets. It will be AIG all over again.

But derivatives are just part of the problem. The real issue is a financial model that doesn't really work and offers no tangible benefit to society. In its present form, the system–with its exotic OTC markets, its off-book SIVs and SPEs, and its opaque Dark Pools and High Frequency Trading– is more snake oil than high finance. It does not "efficiently allocate capital to productive activity" as advertised, but–more often than not–diverts it away from production altogether into paper claims on all manner of financial exotica. So called "innovations" have had less to do with increasing the overall vitality of the economy or improving living standards than they do with circumventing regulations to enhance earnings by maximizing leverage. Deregulation has utterly transformed the system; creating a financial Frankenstein that hides its activities off public exchanges, that transfers the risk of losses onto the taxpayer, and that requires explicit government guarantees just to attract investment. It's a mug's game where only a small group of high-stakes speculators come up winners.

The same is true of the Fed's emergency lending programs. They're just another swindle wrapped in fancy public relations ribbon. Ostensibly, the facilities are supposed to provide cheap capital in exchange for dodgy collateral. But that's not a loan; it's a subsidy, and it helps to obscure the true, market price of the assets. As systemic regulator, the Fed has every right to provide liquidity during times of market stress or turbulence. But it does not have the right to help financial institutions conceal their losses by paying exorbitant prices for downgraded junk bonds. That's picking winners and losers, which is far beyond the Fed's mandate.

Quantitative easing (QE) is another Fed boondoggle. The program has been hyped as a way to get the banks to increase lending to businesses and consumers by creating over $1 trillion of excess bank reserves. But instead of increasing lending, QE does the exact opposite; it creates generous incentives for not lending. The banks who qualify have been taking the Fed's zero-rate reserves and exchanging them for safe, 10-year Treasury bonds which yield 3.5%. What a deal! Fed chairman Ben Bernanke has promised to maintain this policy for "an extended period" which means the banks will continue to reap the benefits of this stealth bailout for the foreseeable future.

This is the real reason the banks aren't lending, because the Fed is paying them not to. It's not a matter of creditworthy applicants. It's a matter of hopelessly mangled monetary policy. The ongoing credit contraction can be blamed on one man alone; Ben Bernanke.

Even though QE is mainly a backdoor way to recapitalize the banks; some lending has continued, although not to consumers and businesses. So where has the money gone? Here's part of the answer from the Wall Street Journal:

> "Former Salvadoran finance minister Manuel Hinds points out in the latest issue of International Finance that banks have indeed been shirking on their day job of transforming increased deposits into increased private-sector credit. But they haven't quit entirely. In fact, they've funneled significant new funds into nonbank financial institutions—which have not lent them on. What's happening is that U.S. banks have been behaving exactly like developing country banks during earlier crises, such as Indonesian banks in the late 1990s—raising lending to their worst borrowers to keep them alive, lest the banks themselves collapse from their borrowers' defaults.
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> For U.S. banks, these zombie borrowers are their affiliated financial entities set up to manage so-called off-balance-sheet activities—such as the famous SIVs (structured investment vehicles) created by Citigroup and others during the boom. Thus, the massive fiscal and monetary bailouts of the banks have served to worsen the credit misallocation that led to the general economic collapse in 2008." ("Prepare for a Keynesian Hangover", Ben Steill, Wall Street Journal)

So the banks are not only taking depositors money and using it in high-risk derivatives transactions and currency "carry trades", they're also propping up the long daisy-chain of insolvent creditors whose default could domino Lehman-like through the entire financial system. Funny how the media skips little tidbits like this when they give their rosy evening roundup.

And then there's this; on Christmas Eve, the Treasury Dept announced that it would lift existing caps on the mortgage-finance giants Fannie Mae and Freddie Mac. The two GSE's will no longer be limited to a ceiling of $200 billion in losses each. Although, the Treasury's action looks like it was designed to support the housing market, the real beneficiaries are the banks whose balance sheets are coming under greater pressure from the relentless uptick in foreclosures. It is widely believed that Treasury is laying the groundwork for a major revision of the Obama's mortgage modification program which has, so far, been a dismal failure. If the critics are right, the administration is planning to slash the principle on millions of mortgages sometime in 2010, thus shifting the sizable losses onto the US taxpayer. Otherwise, the banks will face potential losses on another 4 million foreclosures in the next year alone. (according to Credit Suisse)

Economist Dean Baker says that the Treasury's surprise announcement is an indication that Fannie and Freddie may have paid too much for the mortgage-backed securities they bought back in 2008 when the GSE's were used as a dumping ground for distressed bank assets. Here's Baker:

> "This would mean that they were paying too much for mortgages and mortgage-backed securities bought from banks after the financial meltdown was already in full swing. This was the original purpose of the TARP program. Of course, TARP came with at least some restrictions and disclosure requirements. If Fannie and Freddie are overpaying for mortgages, then there are no conditions whatsoever put on the banks that get the money." (Fannie

Mae and Freddie Mac: Just a four Letter Word, Dean Baker, Huffington Post)

The Treasury's action is tantamount to another stealth bailout by industry reps working within the Obama administration. All policymaking seems to revolve around two fundamental tenets: Increase the profit potential for the big Wall Street banks, and crimp the flow of credit to the real economy to increase privatization, crush the labor movement, and reduce the population to third world poverty. That's Neoliberalism in a nutshell and, apparently, Obama's economic dogma. In fact, as economist L. Randall Wray points out, Obama's new health care bill is just more of the same; another ginormous handout to Wall Street disguised as public policy. Here's Wray:

> "There is a huge untapped market of some 50 million people who are not paying insurance premiums—and the number grows every year because employers drop coverage and people can't afford premiums. Solution? Health insurance "reform" that requires everyone to turn over their pay to Wall Street. Can't afford the premiums? That is OK—Uncle Sam will kick in a few hundred billion to help out the insurers. Of course, do not expect more health care or better health outcomes because that has nothing to do with "reform" … Wall Street's insurers… see a missed opportunity. They'll collect the extra premiums and deny the claims. This is just another bailout of the financial system, because the tens of trillions of dollars already committed are not nearly enough."(Healthcare Diversions Part 3: The Financialization of Health and Everything Else in the Universe" L. Randall Wray)

It's no wonder that the Obama administration's appeal to China to "expand its domestic market" focuses exclusively on health care and retirement programs. Wall Street is just lining up for the next gravy train.

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