GlobalResearch
Center for Research on Globalization

Obama, Wall Street and the US Automakers

Weakening the economy, leaving it even more debt-strapped.

By [Prof Michael Hudson]
Global Research, December 07, 2008
7 December 2008

Region: [USA]
Theme: [Global Economy]

There is a strange double standard in President-elect Obama's largess with the public purse when it comes to Wall Street's banks and insurance companies as compared to his more prudent stance toward bailing out the U.S. auto industry. In his December 7, 2008 interview with Meet the Press he set conditions for an auto industry bailout, but said nothing about setting similar conditions for the financial sector. His words regarding Detroit could just as well have been directed at Wall Street. But they were not.

I think that the Big Three U.S. automakers have made repeated strategic mistakes. They have not managed that industry the way they should have. … What we have to do is to provide them with assistance, but that assistance is conditioned on them making significant adjustments. They're going to have to restructure, and all their stakeholders are going to have to restructure. Labor, management, shareholders, creditors – everybody's going to recognize that they have-they do not have a sustainable business model right now. And if they expect taxpayers to help in that adjustment process, then they can't keep on putting off the kinds of changes that they, frankly, should have made 20 or 30 years ago.

Later in the interview he repeated this position:

… if taxpayer money is at stake … we want to make sure that it is conditioned on a auto industry emerging at the end of the process that actually works, that actually functions. … But I'm also concerned that we don't put 10 or 20 or 30 or whatever billion dollars into an industry, and then, six months to a year later, they come back hat in hand and say, "Give me more." Taxpayers, I think, are fed up.

Fair enough. But isn't this just what Wall Street is asking for? Isn't it coming back for the remaining $350 billion unallocated under the Treasury plan approved by Congress (and endorsed by President-elect Obama) in October, while the Federal Reserve continues to provide "cash for trash" to banks and insurance companies at a rate now approaching $2 trillion?

One may ask why Wall Street's leading offenders – Hank Greenberg of A.I.G., Charles Prince at Citibank – were bailed out as if saving them was saving "the economy" itself, while only the auto executives were told not to pay themselves such exorbitant salaries and bonuses. If the auto industry has a "bad engineering" problem for which it is being held responsible, why aren't the banks, A.I.G. and their enablers – hedge funds on the other side of the deals that the smart boys won and the careless boys let them win – not being held to a similar standard?

The explanation seems to be that the auto executives didn't have a cabinet official like

Secretary Paulson working on their behalf to represent their special interests as being in the interest of the economy as a whole. On their own, they were not in a position to bring the economy crashing down around them if they did not get what they wanted. Only Wall Street is in a position to wreck the economy by plunging it into bankruptcy. It is this power that enables it to represent its interests as being that of the economy at large, and hence deserving protection that no other sector receives, certainly not labor.

What is important to understand is that the bad-loan problem is concentrated at the top layer (the 15% or so wealthiest banks), the big Wall Street conglomerates created after the Clinton Administration embraced the Republican policy of repealing Glass-Steagall and letting banks form non-bank conglomerates. The bailouts do not end up with these banks or with A.I.G. itself, but with their counterparties on the winning side of bets made against the banks and A.I.G. who now want to collect from financial institutions that can't pay. It's like gamblers in a casino that's gone broke, asking the government to bail them out or "the system" will collapse.

What is this system that Congress and Mr. Obama are rushing to strenuously to rescue? Essentially, bank officers and A.I.G. insurance salesmen behaved like casino dealers who did not mind losing as long as they got a paycheck enabling them to live very, very well.

Not all casinos go broke, and the vast majority of U.S. banks and insurance companies avoided making big gambles. The bailout has little to do with them. And it has little to do with "the economy." It has to do with crooked mortgage brokers working for crooked banks who corrupted the political process with their campaign contributions, to make losing bets against clever financial gamblers who borrowed huge enough sums at interest from these banks to leverage their bets that the banks now hold to at least let investment bankers and commercial bankers become the highest paid individuals in human history. But should one say that this unique historical event really is "the economy"? Or is it an excrescence? Would the economy be better off WITHOUT these bank and A.I.G. debts being "made whole"?

Mr. Obama explained that his administration's solution to the bad debt problem will be for the banks to "earn their way out of debt" to the U.S. Government by loading down American homeowners, households and industry with so much MORE debt that the interest charges will rebuild bank balance sheets. What the banks are selling, in short, is debt. This may be thought of as financial pollution. The banks are to make money by pumping debt pollution into the economy.

Is it not hypocritical for Mr. Obama to criticize the auto companies for producing gas guzzlers that pollute the physical environment, without criticizing the big Wall Street campaign contributors for doing the same to the economic environment? "I've had my team have conversations with these folks to see how can you keep the automakers' feet to the fire in making the changes that are necessary," Mr. Obama explained to Tom Brokow, "some people have said let's just send them through a bankruptcy process. Well, even as large a company as GM, in ordinary times, might be able to go through a Chapter 11 bankruptcy, restructure, and still keep their business operations going. When you are seeing this kind of collapse at the same time as you've got the financial system as shaky as, as it is, that means that we're going to have to figure out ways to put the pressure on the way a bankruptcy court would, demand accountability, demand serious changes."

Mr. Obama finished up by saying that "we have to put an end to is the head-in-the-sand approach … And what we still see are executive compensation packages for the auto industry that are out of line compared to their competitors," adding that "it's not unique to the auto industry. We have seen that across the board. Certainly, we saw it on Wall Street."

But he seems not to understand what the problem is. Turning explicitly to the financial crisis, Mr. Obama said, "you, you had a huge amount of debt, a huge amount of other people's money that was being lent, and speculation was taking place on-based on these home mortgages. And if we can strengthen those assets, then that will strengthen the financial system as a whole."

What is wrong with this picture? First of all, the banks were NOT lending out "other peoples' money." This is a myth promoted by Wall Street's academic lobby, the University of Chicago "monetarist" school. Banks create credit – that is, interest-bearing debt – freely, whenever they can get a borrower to sign a promissory note. The loan creates a deposit ("saving," "other peoples' money"). That is the financial reality. Banking is a public monopoly able to create and monetize credit. This monopoly is granted in order to create a financial system that is supposed to finance capital investment in economic growth.

But if banks had done this, they would not have the bad-debt problem stemming from options gambles and fraudulent real estate loans by their immensely profitable mortgage-brokerage subsidiaries and their enormously remunerative predatory legal offices drawing up predatory mortgage contracts. Capital investment today is financed by industrial companies out of retained earnings – if they are able to retain much after paying the junk-bond holders who have borrowed money from banks to take them over and carve them up, not increase their long-term capital investment, research and development.

What is needed is to restructure the financial system so that it does what its lobbyists and academic shills pretend that it does: promote economic growth rather than merely loan the economy down with debt as a means to extract interest charges.

Mr. Obama's second part of his sentence recommending reform proposes to do just the opposite. He has thrown his support fully behind Treasury Secretary Henry Paulson, by pretending that the way to revive the economy and banks it to inflate a debt-fueled real estate boom once again. Prospective home buyers are supposed to go even further into debt in order to provide the banks with enough extra interest charges to earn the money to become solvent again. (They are as deep in Negative Equity as are the subprime mortgage debtors they and their affiliates have victimized.) When Mr. Obama speaks of "strengthen[ing] those assets," namely, homes and office buildings, "then that will strengthen the financial system as a whole."

But it will weaken the economy, leaving it even more debt-strapped.

Articles by: Prof Michael Hudson