# The American Financial Regime

CARD CHECK: "You have nothing to lose but your chains"

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Even though the Federal Reserve is now the biggest single participant in the financial system, the myth of a "free market" still lingers on. It's mind boggling. The Fed has expanded its balance sheet by $2 trillion, guaranteed $8.3 trillion of dodgy mortgage-backed paper, provided a backstop for bank deposits, money markets, commercial paper, and created 8 separate lending facilities to ensure that underwater financial institutions can still appear to be solvent. The whole system is a state subsidized operation buoyed on a taxpayer-provided flotation device which bears no resemblance to an invisible hand. More astonishing, is the massive power grab engineered by the Fed which has taken place without the slightest protest from 535 shell-shocked congressmen and senators. Elected officials have either kept their finger in the air to see which way the political wind is blowing or timidly caved in to Treasury's every multi-billion dollar demand. It's flagrant blackmail and everyone knows it. Congressional oversight is an oxymoron.

Anyone who has followed the financial crisis from its origins knows that the Fed's bloody fingerprints are all over the crime scene. Still, that hasn't stopped well-meaning liberal economists (Krugman, Stiglitz, Reich) from supporting Bernanke's increasingly unorthodox attempts to flood the financial system with liquidity ("quantitative easing") and invoke whatever radical strategy pops into his head. In fact, many of the experts believe that Bernanke should do even more given the sheer size of the meltdown. There's growing support for a gigantic stimulus package ($700 billion) which will focus on road construction, infrastructure, state aid, extensions to unemployment benefits and green technologies. The Obama camp hopes that government programs and deficit spending will make up for the huge losses in aggregate demand which threaten to drag prices down even further in a self-reinforcing deflationary cycle. Even so, its natural to wonder at the wisdom of giving even more power to the very people who created the mess to begin with and who seem more interested in proving their depression-fighting theories than throwing a lifeline to struggling homeowners, consumers or auto workers. Maybe its time to try something different.

So far, Bernanke's monetarist approach has amounted to nothing. The stock indexes are off 45 percent and housing prices continue to plunge. The Fed's low interest rates and lending facilities have helped to keep the banking system from collapsing, but they've failed to get consumers or businesses spending again. The economy is tanking fast. Paul L. Kasriel, the Director of Economic Research at The Northern Trust Company summed up Bernanke's dilemma like this:

"In a sustained housing bust that causes banks to take a big hit to their capital (low interest rates) simply will not matter. This is essentially what happened recently in Japan and also in the US during the Great Depression. Most people are not aware of actions the

Fed took during the Great Depression. Bernanke claims that the Fed did not act strong enough during the great depression. This is simply not true. The Fed slashed interest rates and injected huge sums of base money but it did no good. More recently, Japan did the same thing. It also did no good. If default rates get high enough, banks will simply be unwilling to lend which will severely limit money and credit creation." (Interview with Paul Kasriel; Mish's Global Economic Trend Analysis)

In fact, the banks are just one part of the problem. Another part is the shortage of creditworthy borrowers now that home equity is drying up and the standards for loans have gotten tougher. Most people have seen their personal wealth vanish as hosuing prices fall and and their 401-Ks shrivel to the size of a chickpea. The Fed chairman faces huge obstacles in trying to restart the credit engine and get maxed out consumers spending again.

Bernanke has expanded the money supply at record pace, but to little effect. The money is stagnating in pools because the financial plumbing is still gunked up from troubles in the banking system. The credit-transmission system has broken down causing a generalized contraction throughout the economy. Business activity has dropped off a cliff and consumer confidence is at a 40 year low.  In his Forbes article "What Would Keynes Do?", Former Treasury Department economist, Bruce Bartlett, sheds light on a part of the problem which many of the pundits miss:

"Another problem that policymakers back then didn't grasp is that the money supply's effectiveness depends on how quickly people spend it; something economists call velocity. If velocity falls because people are hoarding cash, it may require a great deal more money to keep the economy operating.

Think of it this way: Velocity is the ratio of the money supply to the gross domestic product. If GDP is $10 trillion and money turns over 10 times per year, then $1 trillion in money supply will be sufficient. But if velocity falls to 9, a $1 trillion money supply will only support a $9 trillion GDP. If the Fed doesn't want GDP to shrink by 10%, it will have to increase the money supply by 10%.

This is essentially the problem we have today. Unlike in the 1930s, the Fed is not allowing the money supply to diminish. Also, we have programs like federal deposit insurance to prevent bank deposits from shrinking. But velocity is collapsing. Banks, businesses and households are all hoarding cash, not spending except for essentials. This is bringing on the deflation that is crippling the economy."

This is why Bernanke has launched his radical intervention, buying bonds, stocks and anything else that will keep asset-prices from crashing. It's an attempt to reignite spending by goosing the market. When businesses and consumers can't sustain demand, the government has to step in and take their place. Otherwise, businesses have to cut costs even more dramatically, sending unemployment soaring while prices continue to nosedive.

The real worry is that Bernanke's pet theory is merely an academic pipe-dream which is doing more harm than good. After all, his strategy is based on a controversial reading of history that is only accepted by disciples of Milton Friedman. The idea that a normal recession morphed into the Great Depression because the money supply decreased by one-third between 1929 to 1932, is likely an oversimplification of a very complex situation. If

Bernanke's calculations are correct, then show us the goods? Why haven't the zero-percent interest rates and the trillion dollar lending facilities stimulated spending? Instead, the equities markets continue to tumble, corporate profits are down, foreclosures are on the rise, commodities are in freefall, and the unemployment lines are winding halfway across the continent. (Unemployment during the Great Depression didn't reach 25 percent for three years. It is actually accelerating faster in 2008 than it did in 1929) So, where's the progress, Ben?

The present list of remedies fail to address the underlying rot in the system itself. That's the problem. There's no doubt that Timothy Geithner and Larry Summers will have better luck mitigating the effects of the slumping economy, but to what end? To stitch together a system which diverts a larger and larger portion of the national wealth to a smaller and smaller group of corporatist and bankers? Is that the measure of success?

(Note: Redistribution US Style: In the United States the top 1 percent of wealth holders in 2001 together owned more than twice as much as the bottom 80 percent of the population. If this were measured simply in terms of financial wealth, i.e., excluding equity in owner-occupied housing, the top 1 percent owned more than four times the bottom 80 percent!)

No thanks. Besides, the financial crisis is not an accident of nature, like a tornado or an avalanche. It's a self-inflicted wound that can be traced back to particular policies that were put in place to shift wealth from one class to another. The low interest rates, the massive leveraging, the undercapitalized institutions, the off-balance sheets operations were all concocted with the same objective in mind. The Fed's repertoire may change, but the results are always the same; they reflect the deeply-held class bias which orders the economy according to the interests of rich and powerful.

Besides, there's reason to believe that Bernanke doesn't fully grasp the fundamental problem, that economic growth in recent years was predicated on a flawed model that can't be restored. Consumers were able to spend beyond their means because their personal assets were greatly inflated by the availability of easy credit and lax lending standards. Now that risk is being repriced, debt deflation has set in and prices are plummeting across the spectrum. Homeowners are feeling the pinch because they can't tap into their home equity which amounted to $800 billion in 2006. The process of lowering interest rates by spreading risk throughout the system (securitization) has frozen over, sending investors fleeing from the stock markets to the safety of US Treasurys and cold hard cash. Bernanke's attempts to reflate the bubble by buying up Fannie and Freddie's mortgage-backed securities (MBS) and bundled credit card debt from finance companies is a sign of utter desperation. He's like a man pumping air into a punctured tire, pushing up and down furiously while the air hisses out the other side.

The economy is contracting because the excessive spending was based on artificially low interest rates and debt leveraging. In The End of Prosperity Fred Magdoff and Paul Sweezy wrote:

"In the absence of a severe depression during which debts are forcefully wiped out or drastically reduced, government rescue measures to prevent collapse of the financial system merely lay the groundwork for still more layers of debt and additional strains during the next economic advance." As Minsky put it, "Without a crisis and a debt-deflation process to offset beliefs in the success of speculative ventures, both an upward bias to prices and ever-higher financial layering are induced." (John Bellamy and Fred Magdoff, "Financial Implosion and Stagnation", Monthly Review)

This is the market model that Bernanke and Paulson are trying to resuscitate, but without much success. The credit that once gushed from the hedge funds and investment banks has slowed to a trickle. It's no longer possible to take complex debt-instruments and amplify their value 30 or 40 times over. Investors have seen through the swindle and boycotted the market for pools of debt packaged as securities. As foreclosures rise, the banks balance sheets will continue to hemorrhage, forcing them to make margin calls that will push more and more financial institutions into bankruptcy. It can't be stopped. This is what happens when the underlying economy can no longer support an oversized financial system where wages have stagnated and workers are unable to make the interest payments of their loans. The whole system begins to buckle. John Bellamy and Fred Magdoff explain the origins of "financialization" in their article "Financial Implosion and Stagnation":

"It was the reality of economic stagnation beginning in the 1970s, as heterodox economists Riccardo Bellofiore and Joseph Halevi have recently emphasized, that led to the emergence of "the new financialized capitalist regime," a kind of "paradoxical financial Keynesianism" whereby demand in the economy was stimulated primarily "thanks to asset-bubbles." Moreover, it was the leading role of the United States in generating such bubbles—despite (and also because of) the weakening of capital accumulation proper—together with the dollar's reserve currency status, that made U.S. monopoly-finance capital the "catalyst of world effective demand."

Magdoff and Bellamy's theory confirms that there was a plan to expand financial markets into riskier areas to compensate for the stagnation which unavoidably occurs in capitalist economies. The real problem is rooted in the hostility of corporate bosses towards workers which translates into wages that don't keep pace with production. When wages languish, in an economy that is 70 percent consumer spending, the only way to increase GDP is by expanding credit. And that, in fact, is exactly how it has played out. Trickle down ideologues, like Henry Paulson, make every effort to extend credit to anyone with a pulse and a body temperature of 98.2 degrees, but they fight tooth and nail to crush the unions or any attempt to raise salaries. And Paulson, of course, is not alone in waging class warfare; he is just an extreme example.

The bottom line, is that financialization, which rests on the twin pillars of easy credit and ballooning debt, creates an inherently unstable system which is prone to wild swings and frequent busts. Bernanke is trying to restore this system ignoring the fact that workers–whose personal balance sheets are already bleeding red–can no longer support it. No amount of tinkering in the credit markets will reduce the overcapacity bulging throughout the system or add one farthing a poor man's bank account. There is a historic mismatch between supply and demand that cannot be reconciled by Bernanke's market meddling. Workers need a raise, that's how demand is created.

The same message goes out to Obama's economic team, too. The stimulus package might get the economy through the short-term rough patch, but if wages don't rise, the economy will continue to underperform. That's why the new commander in chief would be well advised to quickly pass The Employee Free Choice Act (also known as "card check") which would end secret ballots in union elections. It may be the most important piece of legislation in a decade. Its passage would ease union organizing and help to grow union membership which has dwindled to about 10 percent of the work force.

Forget about the fake differences between the two political parties. There aren't any. The only hope for deep structural change is to strengthen the unions and give workers a place at the policy table. That's the only peaceful way to dismantle this parasitic financial regime and bring about a more equitable distribution of wealth.



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