# The Financial Sector: “A House Burning Down”

Ben Bernanke’s False Analogy

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On the March 15 CBS show “60 Minutes”, Federal Reserve Chairman Ben Bernanke used a false analogy already popularized by President Obama in his quasi-State of the Union Speech. He likened the financial sector to a house burning down – fair enough, as it is destroying property values, leading to foreclosures, abandonments, stripping (for copper wire and anything else recoverable) and certainly a devastation of value. The problem with this analogy was just where this building was situated, and its relationship to “other houses” (*e.g.*, the rest of the economy).

Mr. Bernanke asked what people should do if an irresponsible smoker let his bed catch fire so that the house burned down. Should the neighbor say, “it’s his fault, let the house burn”? That would threaten the whole neighborhood with fire, Mr. Bernanke explained. The implication, he spelled out, was that economic recovery required a strong banking and financial system. And this is just what he said: The economy cannot recover without yet more credit and debt. And that in turn requires trillions and trillions of dollars given by “the neighbors” to the bad irresponsible man who burned down his own house. This is where the analogy goes seriously off track.

But watching “60 Minutes,” my wife said to me, “That’s just what Mr. Obama said the other night. What do they do – have a meeting and agree on what metaphor to popularize?” They seem to have an image that will lock Americans into supporting a policy even though they don’t like it and many feel like letting the financial house (A.I.G., Citibank, and Bank of America/Countrywide) burn down.

What’s false about this analogy? For starters, banking houses are not in the same neighborhood where most people live. They’re the castle on the hill, lording it over the town below. They can burn down and leave the hilltop revert “back to nature” rather than having the whole down gaze up at a temple of money that keeps them in debt.

More to the point is the false analogy with U.S. policy. In effect, the Treasury and Fed are not “putting out a fire.” They’re taking over houses that have not burned down, throwing out their homeowners and occupants, and turning the property over to the culprits who “burned down their own house.” The government is not playing the role of fireman. “Putting out the fire” would be writing off the debts of the economy – the debts that are “burning it down.”

To Mr. Bernanke the “solution” to the debt problem is to get the banks lending again. He’s *spreading* the debt-fire. The government is to lend the “threatened neighbors” enough money so that credit customers of the financial “house on the hill” can to pay it the stipulated interest charges they owe. It is not burning down at all; the neighborhood’s money (in this case, tax money) is being burned up.

Mr. Bernanke explained to the Sunday evening audience that his policy aimed at helping the economy return to "normalcy." Fully in line with what Mr. Paulson was saying last summer, "normalcy" is defined as a new exponential growth in the volume of debt. He talked about "sustainable" recovery. But "the magic of compound interest" is not sustainable. It's all a false metaphor.

Mr. Bernanke then left the realm of metaphor altogether to give an outright false explanation of the balance of payments and the upcoming Gang of 20 meetings in Europe. On Friday, China's premier expressed worry over the health of the American economy, in which China had recycled nearly $2 trillion of its dollar inflows in order to prevent the yuan from rising in price against the dollar. The fear is that despite this heavy recycling of dollars by foreign central banks, the U.S. exchange rate will still weaken as the trade balance continues unabated and, just as seriously, U.S. military spending keeps on pumping dollars into the world economy as war spreads eastward from Iraq to Afghanistan and Pakistan.

The way Federal Reserve Chairman Bernanke explained the problem on CBS, America had to keep its markets attractive to "Chinese savers." The image being conjured up again and again is that there is a world "savings surplus." That is supposed to be what flooded the large U.S. banks and Wall Street with so much money that they were obliged to move it into riskier and riskier investments. "They made us do it" was the message not quite spelled out.

One would think that Mr. Bernanke knows nothing at all about the balance of payments or how the global monetary system works. Here's what really has been happening. The U.S. economy itself pumps "savings" into foreign central banks by spending abroad on military bases. (60 Minutes showed robot fork-lift machines moving around $40-million loads of U.S. currency through the New York Federal Reserve Bank the way that similar machines have been doing in Iraq to buy off local supporters and political groups.) U.S. consumers likewise buy more than the country is exporting. When these surplus dollars are turned over to foreign banks for domestic currency, the banks turn them over to the central bank – which has a problem.

Remember when an earlier U.S. Secretary, John Connolly, said "It's our deficit, but their problem"? He meant that the U.S. was spending funds (at that time mainly in Southeast Asia) that ended up in foreign central banks, which faced a dilemma: If they let "the market" handle these dollars, their own currency would rise. That would threaten to price their exports out of world markets, and hence would cause domestic unemployment. So foreign governments chose to recycle their dollar inflows by keeping them in dollars – mainly in U.S. Treasury bills and then, when the supply began to run out, in federal agency securities such as Fannie Mae and Freddie Mac.

So the "fire" in the international sphere was the U.S. military-spending deficit and trade deficit. This doesn't have much to do with Chinese consumers saving too much. Central banks were doing the quasi-saving, by being stuck with surplus U.S. dollars like a hot potato. But one rarely hears public officials mention the nation's military deficit. It is as if foreign saving comes first, then a "market-based" decision to place these in the U.S. economy, "the engine of world growth." What actually comes first is the U.S. balance-of-payments deficit, pumping surplus dollars into the economy – which foreign central banks find themselves obliged to recycle within the dollar sphere. (This is the phenomenon I discuss in *Super*

*Imperialism: The Economic Strategy of American Empire*, and *Global Fracture*.)

As for the surplus credit that Wall Street lent out, it is created out of thin air. At least Mr. Bernanke was clear about this, when he explained that the Fed "creates deposits" for its member banks just as these banks "create deposits" for their own customers at a stroke of the computer keyboard.

The bottom line is that the American public is being fed a carefully crafted mythology (no doubt "market tested" on "response groups" to see which images fly best) to mislead the American public into misunderstanding the nature of today's financial problem – to mislead it in such a way that today's policies will make sense and gain voter support.

But this mythology is based on false analogies, not economic reality. It is designed to make Wall Street appear as a savior, not an arsonist – and to depict the Fed and Treasury as protecting the welfare of American citizens by shoveling billions of dollars at the banks whose gambles have caused the crisis.

While Mr. Bernanke's "60 Minutes" interview was being broadcast, the government was releasing the counterparties on the winning side of the Wall Street casino in bets that A.I.G. lost. To deflect the widespread voter disapproval of giving $160 billion to A.I.G., the Treasury finally released the names of the "counterparties" who ended up with the funds A.I.G. paid out to winning betters. Confirming rumors that had been circulating for the past few months, Mr. Paulson's own company, Goldman Sachs, headed the list at $13 billion! Followed by Merrill Lynch ($7 billion), Bank of America ($5 billion), Citigroup ($23 billion and the much-loathed junk-mortgage lender Wachovia ($1.5 billion). So as Treasury Secretary, Mr. Paulson turns out to have represented not the U.S. interest but that of his own firm and its Wall Street neighbors.

These neighbors were given U.S. Treasury bonds in "cash for trash" transactions. The rest of the economy will be paying interest on this debt for a century to come. This is what causes "debt deflation." Revenue is diverted from spending on goods and services to pay interest and taxes. So the Treasury is spreading the fire, not putting it out.