# The Obama Letdown

Ilusory "Mandate for Change"

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Reality had to raise its ugly head. Barack Obama was elected with overwhelming approval to inaugurate an era of change. And at his November 25 press conference, he said that his decisive victory gave him a mandate to change the direction in which America is moving. But his recent economic and foreign policy appointments make it clear that when he chose "change" as his campaign slogan, he was NOT referring to the financial, insurance and real estate (FIRE) sectors, nor to foreign policy. These are where the vested interests concentrate their wealth and power. And change already has been accelerating here. Unfortunately, its direction has been for the top 1% of America's population to raise their share of in the returns to wealth from 37% ten years ago to 57% five years ago and an estimated nearly 70% today.

The change that Mr. Obama is talking about is largely marginal to this wealth, not touching its economic substance – or its direction. No doubt he will bring about a welcome change in race relations, environmental regulations, and a more civil rule of law. And he probably will give wage earners an income-tax break (thereby enabling them to keep on paying their bank debts, incidentally). As for the rich, they prefer not to earn income in the first place. Taxes need to be paid on income, so they take their returns in the form of capital gains. And simply avoiding losses is the order of the day in the present meltdown.

Where losses cannot be avoided, the government will bail out the rich on their financial investments, but not wage earners on their debts. On that Friday night last October when Mr. Obama and Mr. McCain held their final debate, Mr. Obama was fully on board with the bailouts. And this week's appointment of the "Yeltsin" team who sponsored Russia's privatization giveaways in the mid-1990s – Larry Summers and his protégés from the Clinton's notorious Robert Rubin regime – shows that he knows his place when it comes to the proper relationship between a political candidate and his major backers. It is to protect the vested interests first of all, while focusing voters' attention on policies whose main appeal is their ability to distract attention from the fact that no real change is being made at the economic core and its power relationships.

This is not what most people hoped for. But their hopes were so strong that it was easier to indulge in happy dreams and put one's faith in a prince than to look at the systemic problems that need to be restructured in order for real change to occur. Individuals do not determine who owes what to whom, who is employed by whom or what laws govern their work and investment. Institutional economic and political structures are the key. And somehow the focus has been on the politics of personalities, not on the economic forces at work.

This is as true abroad as it is in the United States. Two weeks ago I was at an economic meeting on "financialization" in Germany. Most of the attendees with whom I spoke expressed the hope – indeed, almost a smug conviction – that Obama would be like Gorbachev in Russia: a man who saw the need for deep structural change but chose to bide his time, seeming to "play the game" with the protective coloration of going along, but then introducing a revolutionary reform program once in office.

Instead, after resembling President Carter by running a brilliant presidential primary campaign to win the nomination (will a similarly disappointing administration be about to come?), Obama is looking more like Boris Yeltsin – a political umbrella for the kleptocrats to whom the public domain and decades of public wealth were given with no quid pro quo.

Obama's ties with the Yeltsin administration are as direct as could be. He has appointed as his economic advisors the same anti-labor, pro-financial team that brought the kleptocrats to power in Russia in the mid-1990s. His advisor Robert Rubin has managed to put his protégés in key Obama administration posts: Larry Sommers, who as head of the World Bank forced privatization at give-away prices to kleptocrats; Gaithner of the New York Fed; and a monetarist economist from Berkeley, as right-wing a university as Chicago. These are the protective guard-dogs of America's vested interests.

If you are a billionaire, your first concern is simply to preserve your wealth, to avoid having to take a loss in the value of your financial claims on the economy – claims for repayment of loans and investment, as well as interest and dividends, and enough capital gains to compensate for the price inflation that erodes the spending power of more lowly income-earners.

This year has changed the typical fate of financial wealth in the face of bursting financial bubbles. Traditionally, business booms culminate in a wave of bankruptcies that wipe out bad debts – and the savings that have been invested on the "asset" side of the balance sheet. This year has changed all that. The bad debts are being kept on the books – but transferred from the banks to the federal government, mainly the Federal Reserve and Treasury. The bank bailouts have aimed not so much to protect the banks themselves, but to enable them to pay off on the bad bets they made vis-à-vis the nation's hedge funds and other institutional investors in the derivatives market.

To participate in a hedge fund, one needs to prove that one can afford to lose their money and not be much the worse off for it in terms of actual living conditions. So the $306 billion in federal guarantees of the junk mortgage packages sold by Citibank, and the $135 billion bailout of the insurance contracts written by A.I.G. to protect swap contracts from loss, could have been avoided without much impact on the "real" economy.

In fact, writing down these financial claims ON the economy would have paved the way for writing down its debt burden. If the subprime and other mortgage debts had been permitted to decline to the neighborhood of 22 cents on a dollar they were trading for, this would have made it possible to write down debts to match the price at which mortgage holders had bought these loans for. But the financial overhead of American wealth "saved" in the form of creditor claims on indebted homeowners, industrial companies and junk-insurance companies such as A.I.G. has been protected against erosion by this year's federal bailout program.

Bloomberg has added up these programs and finds that they $7.7 trillion dollars –

nearly half an entire year’s GDP. By acting to support the market for bad-mortgage loans (but not for real estate itself), the seemingly endless series of Paulson bailouts seeks to be to keep today’s debt overhead intact rather than writing it down. Service charges on this indebtedness will divert peoples’ income from consumption to paying creditors. It will help financial investors, not labor or industry. It will keep the cost of living and doing business high, preventing the U.S. economy from working its way out of debt by becoming competitive once again.

With all these trillions of dollars of bailing out the wealthy, one might easily forget to ask what is being left out. For one thing, the government’s Pension Benefit Guarantee Corp, whose $25 billion deficit is not bailed out. This year, underfunded corporate pension plans are supposed to “catch up” to full funding so as to protect the PBGC, in accordance with a law passed by Congress two years ago. If underfunded plans don’t meet the scheduled 92% coverage for this year, they have to bring their set-asides fully up to the 100% funding level. The stock market plunge has dashed their hopes to do this. The result will be to force many industrial companies into a financial bind.

On the auto front, the Bush Administration has brought pressure to force the big three Detroit companies into bankruptcy as a way to annul their defined-benefit pension plans – with no plans at all bail out money owed to labor by restoring the PBGC to solvency. State and local pension plans are almost entirely unfunded, and are at even more risk as their tax revenues plunge and property tax payments are stopped on housing and commercial buildings that have foreclosed.

And speaking of state and local finances, what role is local government to play in Mr. Obama’s promise to rebuild infrastructure, headed by transportation? Given their strapped position, one is hearing a surge of Wall Street plans to spend enormous sums. Whereas Obama’s economic team made fortunes for Russian kleptocrats by giving them public-sector assets already in place, their American counterparts are going to have to get rich by actually building new projects. In such cases the benefits are as large as the total amount of money being spent – but not in the way that most people understand at first glance. Construction contracts for new public transport systems, bridges and roads and urban or rural modernization may be entirely honest and provided at a fair cost. But it is a byproduct of such investment that it creates an amount that is of equal or often even greater magnitude in the form of rent-of-location – that is, vast windfall gains for well-located real estate.

This is where Mr. Obama’s Chicago political experience comes in so handy. It is in fact a game tailor-made for his team. Hundreds of millions of dollars were made in gentrifying Chicago’s notorious but conveniently centrally located public housing for low-income families. The developments sponsored by Mr. Obama’s mentors, the Pritzker family, the University of Chicago and assorted real estate reverends opened up vast new land sites, with public support to boot. (The house where I grew up in Hyde Park-Kenwood, a block or so from Mr. Obama’s house, was torn down along with the rest of the entire block as part of Mayor Daley’s urban renewal program in the late 1950s – after the University’s block busters had run down the neighborhood, then panicked the whites into selling to the blacks at extortionate price markups and mortgage rate premiums, then tearing down the houses into which the blacks had moved. It’s an old real estate game that one learns quickly in Chicago politics.) As Thorstein Veblen noted, any American city’s politics is best understood by viewing it as a real estate development.

The gains from providing better transport infrastructure typically are so large that transportation investment could be self-financing by taxing these property gains – recapturing the added rental value in the form of property windfall taxes. London's tube extension to Canary Wharf, for example, cost the city £8 billion – but increased real estate values along the route by some £13 billion. The city could have financed the entire project by issuing bonds that would have been repaid out of taxes levied on the windfall gains created by this public expenditure.

Likewise in New York City, the transport authority has just announced that subway and bus fares will be jacked up (adding no less than $10 to the monthly commute card) and services cut back sharply. Mayor Bloomberg has just stopped work on the 2nd Avenue subway, its completion will add at least as much to upper East Side property values as the subway costs itself. The city thus could finance its construction not by issuing bonds to be paid off by city and state taxpayers in combination with user fees paid as fares. Taxpayers wouldn't have to pay, and riders could enjoy subsidized fares simply by taxing the real estate owners.

But I see no prospect of this being done. Real estate is still the name of the game, because it remains the largest asset category in every economy today just as much as under feudalism. The difference from feudalism is that whereas landlords received the rental value of their lands in centuries past, today's property owners acquire ownership not by military conquest (the Norman invasion of 1066 in England's case) but by borrowing from the banks. To a mortgage banker, a commercial developer or real estate company is a prime customer, the bulwark of bank balance sheets. It is hard to imagine a new American infrastructure program not turning into a new well of real estate gains for the FIRE sector. Real estate owners on favorably situated sites will sell out to buyers-on-credit, creating a vast new and profitable loan market for banks. The debt spiral will continue upward.

The fact that state and local budgets are too burdened to afford infrastructure spending themselves will lead to it being privatized from the outset. Probably London's notorious public-private partnerships (a Labour Party refinement more Thatcherite than even Margaret Thatcher herself could have got away with) probably will become the basic model. Users will pay higher fees rather than enjoying the subsidized or free access typical in public infrastructure spending during the Progressive Era. The main purpose of public enterprise back then was to keep prices down for basic services, thus lowering the cost of living and doing business in America. But today, infrastructure spending will be just one more item adding to America's debt overhead to make its economy even less competitive with foreign ones than it is.

The moral is, next time a candidate promises change, ask him to say just what changes he has in mind. During the Presidential debates, only Dennis Kucinich came out and said each specific law that he had put before Congress to implement each change he promised. But most of the public didn't want to know the details – they simply liked hearing the word "change."

Here are some purely fiscal and financial changes that a future presidential candidate might propose – changes that I don't expect to be hearing any more about during the next four years. Just to get the discussion going, why shouldn't these merely marginal changes within the existing system be implemented right now by a presidential candidate who is still bragging about his "mandate for change":

* Regarding fiscal policy, re-introduce the estate tax, along with (at the very least) the Clinton era's progressive-tax schedule.

* Tax capital gains at the same rate as wages and profits, rather than at half the rate; and make these taxes be paid at the point of sale of real estate or other assets, not deferred *ad infinitum* if the gains simply are invested in yet more wealth.

* Require a cost-benefit analysis of any publicly backed infrastructure spending so as to recapture all "external economies" (such as windfall real estate price gains) as the first line of financing such investment.

* Tax corporate borrowing that is used merely to pay stock dividends or buy back one's own stock at least at 50%.

* Close the practice of offshore tax avoidance, and bring criminal cases against accounting firms abetting this practice.

* Only let a building be depreciated once, not repeatedly as a tax writeoff.

* Refocus state and local taxation on the property tax, remembering that whatever the tax collector relinquishes is simply "freed" to be paid to the banks as interest.

* In the sphere of bad-debt banking, when a government agency takes over a bank or company that has negative net worth, the stockholders must be wiped out as their stock has lost all market value. Bondholders must stand in line behind the government in case of insolvency.

* Write down mortgage debts to the ability of property owners to pay and/or the present market value. Banks that have made loans to these borrowers must take responsibility for their decision that the owners could afford to pay. Even better, apply New York State's existing Fraudulent Conveyance law, and simply annul loans that are beyond the ability of debtors to pay.

None of this involves real structural change. It is simply more economically efficient under existing laws and practices – something like actually enforcing environmental law, anti-fraud and anti-crime laws, and the original intent of our tax legislation. It is a small step back toward the Progressive Era a century ago – the era that set America on the path of prosperity that made the 20th century the American century.



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