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Why Bailing Out Banks Doesn't Work

By Shamus Cooke
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The New York Times recently posed an excellent question: "Why save banks if they won't lend?" (January 19, 2009)

Before the first $350 billion "installment" of the bailout, we were told that the money was needed to "unfreeze" the credit markets, meaning that banks would again be willing to lend businesses the money they needed to continue doing business.

Despite hugely popular opposition, the bailout proceeded, and absolutely nothing changed.

The congressional "representatives" who passed the bailout bill acted shocked: instead of giving loans, the banks hoarded the money, bought other banks, and continued to pay the lavish salaries and bonuses to CEOs. Meanwhile, the economy continued to crumble.

The politicians couldn't possibly be surprised by the lack of lending since they obediently put no conditions on the banks upon receiving the money.

Questions still remain: why won't the banks lend? And what are we to do about it?

It must first be noted that banks are hoarding money because it allows them to stay solvent, i.e., avoid bankruptcy. During the housing boom, money was cheap and banks borrowed and lent far more than they should have. It wasn't simply irresponsibility; it was the need to compete with other banks that were likewise making gigantic profits at the time.

The borrowing and lending pyramid scheme came to an end when the borrowers at the bottom were unable to pay on their loans; the banks then realized that they had not enough assets to cover the money that they had borrowed from other banks and depositors, and cried for the taxpayer to rescue them. The bailout money is thus being used to align the bank's assets with liabilities.

Another reason the banks are not lending is because they doubt they'll get paid back. The corporations attempting to borrow from them are struggling to avoid bankruptcy themselves, as consumers are buying less of their products than before.

Also, corporations are already heavily indebted to banks — the combined result is that banks either deny loans altogether or force businesses to "pay much higher interest rates than they did a few years ago, putting more strain on [corporate] balance sheets already hammered by falling profits and a grinding recession" (The New York Times, January 19, 2009).

Individuals face the same problems as corporations: they are hugely in debt and have little money to service their debts, let alone take on additional debt.

All this leads us to the current situation. Obama recently lobbied his colleagues in Congress to release the second $350 billion bailout installment to the banks. It took all of Obama's persuasive powers to convince his fellow Democrats to follow suit since everybody was aware that the previous $350 billion served only the banks, and even Congressmen are not immune to the hot breath of hatred from their "constituents."

This time, however, Obama promised that things were going to "change." No longer would the banks be able to do whatever they liked with the bailout money — they would have to start making loans. But a new problem was instantly created. How was Obama to ensure the banks would actually follow through with his decree? Obama's rhetoric was far too vague to answer this question.

The New York Times attempted to address the issue and noted that it was an international phenomenon, as governments everywhere were bailing out "their" native banks with no strings attached and no new loans being made.

The Times warned, however, that a "get tough" stance on the banks would be unwise. The only way that any government can actually enforce the above words of Obama is by taking a majority ownership in the banks, i.e., nationalizing them.

Doing this, The Times noted, scares away the bank's shareholders — all rich investors — who may lose all of their money in the process. The rich do not like being told what to do with their money or risking large chunks of it. The result is that they take their money and sit on it, or invest abroad with less repressive governments.

Not only this, but the rich are also afraid of the example that nationalization could create. If people saw that a section of the economy could be taken over and run for a specific purpose — instead of a blind market that benefits only the rich — they may demand similar acts for other parts of the economy, perhaps even for the economy in its totality.

Ultimately a conundrum is created: the economy cannot function unless the banks are forced to lend, but if the banks are taken over, the super rich may flee, taking with them the money needed to restore the economy.

The Obama administration is incapable of solving this problem, committed as he is to the interests of the rich, i.e., maintaining a broken capitalism. It is possible that he may be forced to nationalize a bank or two out of inescapable necessity, but any further measures will force him to encounter the above problems.

We cannot prevent the super-rich from fleeing if their property is nationalized, but we can prevent them from taking billions of dollars with them. This type of measure, however, would require a government dedicated to actual social change, not simply talk. It would also require that the government not be controlled by the banks and other corporations.

Such a government will not come into existence unless we organize and fight for it. A promising step forward in this direction can be taken by joining the emerging coalition in support of the Workers Emergency Recovery Campaign (www.wercampaign.org).

The super rich have all kinds of lobbyists, organizations, and institutions that they use to promote their interests. The working class needs similar tools for their own purposes.

Shamus Cooke is a social service worker, trade unionist, and writer for Workers Action (www.workerscompass.org). He can be reached at shamuscook@yahoo.com

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