Barack Obama's Economic Recovery Plan.

Interview with Prof. Jack Rasmus

By Workers Emergency Recovery Campaign
Global Research, March 08, 2009
WERC 8 March 2009

Region: USA
Theme: Global Economy

The following is an interview with Prof. Jack Rasmus by the Workers Emergency Recovery Campaign (WERC). Rasmus is a professor of economics at St. Mary's College and Santa Clara University in Northern California. Below he outlines the details of Obama's economic recovery plan, showing the plan's inadequacies and the resulting implications.

WERC: What is your assessment of Obama's economic recovery plan? Can you describe it for our readers and tell us if you think it will deliver the jobs and benefits that people are anxiously awaiting?

Jack Rasmus: The Obama Plan has five major components, The first is the $787 billion stimulus plan that was adopted recently by the U.S. Congress. The second, third and fourth parts aim to resuscitate the financial markets: Part 2 is the PPIF, or Public-Private Investment Fund; Part 3 is the TALF, or Term Asset-Backed Securities Loan Facility; and Part 4 is the Homeowner Affordability and Stability Plan. The fifth component is Obama's proposed 2009 budget — which is likely to be modified substantially by the Republicans before it is finally adopted.

As for the stimulus package: As I have stated repeatedly, it's too little too late. First, it's not a jobs bill. By the end of 2009, there could be a total of 20 million people unemployed. We are now at 14 million jobs lost, and the job losses are accelerating. Over the past three months, we lost one million jobs each month, when job losses are calculated correctly. This package is not going to regenerate the jobs that we are talking about — and jobs are the most important thing, because job loss is what's driving the collapse of consumption and bringing down the economy.

Thirty-eight percent of the stimulus package goes to providing aid; that is, unemployment, food stamps, vets' benefits, medical aid, COBRA — as well as aid to state and local governments. This is all necessary, but what it shows is that this plan is aimed at softening the collapse, not at creating jobs. This aid will have little effect in terms of job creation. As for the aid to state and local governments, it is nowhere near the amount needed to halt the massive job cuts in state after state.

WERC: This is clear. In California Republican Governor Arnold Schwarzenegger is demanding that public-sector workers across the state take two days off per month with no pay. His plan also calls for tens of thousands of layoffs statewide.

The Progressive States Network (PSN) reported that the Obama stimulus plan would cover less than half of projected state deficits. The authors of the PSN report note, "A new study by the Center on Budget and Policy Priorities details that state deficits are projected to be

$350 billion over the next 30 months. But the stimulus recovery plan includes only about $150 billion that can be used to address those shortfalls, meaning that 55% to 60% of projected state deficits will remain."

Rasmus: Indeed. These "shortfalls" will mean millions of destroyed jobs, lives, families, and entire communities.

To continue with the stimulus plan: Another 38% of the package, or $300 billion, is tax cuts: (1) business tax cuts, (2) reversing the alternative minimum tax; and (3) payroll tax cuts. The business tax cuts will not have any effect in stimulating the economy. Some economists in fact are arguing they will have a negative effect that the spending from the tax cuts will be less than the amount of the tax cuts; they call this "negative multipliers."

When you're in a deep downturn like this, businesses sit on their tax cuts, waiting for better days ahead; they use the money to pay off their debts and that sort of thing. Even the payroll taxes will have virtually no effect in terms of consumption and stimulating the economy.

Only 24% of the stimulus plan, or $200 billion, will go to federal spending, with just $27 billion allocated this year to job-creating expenditures. The rest is long-term alternative energy technology and other similar projects, all of which are capital intensive.

The point is this: It's not a jobs bill. Obama says the plan will create 3 million to 4 million jobs. But over what time period? It's over multiple years, with the hope that the biggest impact will come in the second year.

This year the total spending impact of this bill, dollar-wise, is only $180 billion, which is roughly what 2008 stimulus package was last year. It had virtually no effect last year, and the conditions are even worse this year. We will continue to be gushing jobs this year at the continued rate of half a million to 1 million jobs per month.

We're going to be in very bad shape at the end of the year. The number one cause driving foreclosures is job loss. I was just reading a statistic today that 72% of all the sub-prime loans issued between 2005 and 2007 are going to default. In other words, we haven't seen the total impact of the housing price collapse. Housing prices will fall at least another 20%. There is no light at the end of this downturn tunnel.

With 20 million unemployed at the end of the year, with an additional 5 million to 7 million people losing their homes to foreclosure, the stimulus plan fails miserably when it comes to creating jobs — so bad that I predict they will have to come up with a Stimulus Plan II at some point.

So if there not a program this year to deal with this situation, the odds go up significantly that what I call an epic recession will become a classic global depression in 2010. We are on the cusp of this now. The momentum is moving in that direction.

WERC: Let's look at the other components of Obama's program. You mentioned that the administration is putting most of its hopes into reviving the banking system as a means to jump-start the economy. What about the Public-Private Investment Fund, for example?

In mid-February Treasury Secretary Tim Geithner announced that up to $1 trillion would be provided by the Treasury to "provide financing for private investors to buy 'distressed securities.'" Geithner said the the goal is to clean up the banks' "toxic assets so that the credit crunch that is hobbling the economy can be ended." What is your take on the PPIF?

Rasmus: This is really Part Two of the big banks' rescue plan — and the $1 trillion figure that Geithner presents is just for starters; the figure is going to increase significantly.

As you say, they plan to use taxpayer money to help the banks and investors buy bad assets that exist in these banks and financial institutions. It's the existence of these bad assets that prevent the banks from making loans to businesses and homeowners. It's what's been clogging up the system.

But the Treasury has refused to deal with these bad assets. If you go back to then-Treasury Secretary Henry Paulson and the Troubled Assets Relief Plan (TARP), you can see that we gave the banks $700 billion in bailout funding. But Paulson didn't buy up the bad assets, which was the whole idea behind the rescue plan. Why is that?

It's because the banks are on strike. The banks don't want to lend, or if they do, it's at ridiculously high rates. They don't want to sell all the bad assets on their books because they are essentially worthless now, and they don't want to sell at their worthless market price.

If they sold them at their market prices, they would have even greater losses than they have now. They don't want to loan when their balance sheets are so negative, because if they loan that reduces their reserves on hand. And this is freezing up the system.

Paulson and TARP could not buy them at above-market prices because Congress was looking over their shoulders and saying, "Hey! What are you doing, subsidizing these banks, giving them more than the market value of these assets?"

So, Paulson looked around, saw that he couldn't do anything, and did nothing in relation to these bad assets.

Today, with the PPIF, we have essentially the same situation, but with a little twist.

What they're trying to do with PPIF is to create a market price to sell these bad assets, thereby subsidizing not only the banks but the investors who would buy them. In other words, this $1 trillion is designed to give money incentives to the banks to make up the difference between what the price would be and what the market value would be. So, they are giving the banks a windfall to encourage them to sell at above-market price.

At the same time, they're giving an incentive to the investors; in other words, they are subsidizing the investors as well, with taxpayer money, to come in and buy. They hope this will create a new market price that will take off on its own and unblock the lending. It's going to cost well over $1 trillion to get that going, and it's really questionable whether investors will want to buy those bad assets at any price.

WERC: All the business media report that investors are not willing to buy these assets, even at higher rates. …

Rasmus: That's right. And if the $1 trillion doesn't work, the government is prepared to throw more money at them. The investors know this, so they are going to sit and wait, saying that the price is not high enough and that you have to subsidize us even more. With the government already so committed to this effort, they will throw more money at the banks. Geithner and Obama are already saying that this is just a start, and that we may have to throw more money into this bad assets plan some time soon.

WERC: Some economists, and even some top-level financial gurus such as Former Federal Reserve chief Alan Greenspan, are saying that the government should simply take over and nationalize these bad assets. They say the Obama plan is doomed to fail.

Rasmus: The banks would love this. Keep in mind that Obama and Geithner are not talking about confiscating these bad assets. They are talking about is buying them. But they would have to buy at above-market price because the banks won't sell them. The bankers are holding out for even-higher prices. That's the crux of the problem.

And when Greenspan and the others talk about nationalization, we must be clear, that's a misnomer. They don't really mean nationalization. Buying preferred stock or even common stock does not amount to nationalization. It's just partial receivership, or subsidization, at taxpayer expense.

Seizure of private companies on behalf of investors is not nationalization. Their goal is to buy the bad assets and then sell them back to private investors at below-market prices — all at taxpayers' expense.

WERC: What is the total amount of bad assets, assuming there's agreement on the amount?

Rasmus: Professor Rubini at New York University estimates that there's at least $3.6 trillion in bad assets. Fortune magazine says $4 trillion. Geithner, last June, indicated he thought there was about $6 trillion.

So to buy these bad assets, the taxpayers; would have to fork over $6 trillion.

WERC: The figure is staggering. Clearly, this situation calls out for true nationalization.

Rasmus: Yes, it does. But what is true nationalization? It means totally taking over these banks and financial institutions — with bondholders and shareholders not just taking a haircut, but taking a scalping. It means getting rid of management. It means consolidating and running these banks on behalf of the interests of the working-class majority in the country. You don't pay dividends. You don't pay stock shares. you take full day-to-day operational control of all strategic decision-making. You run it and turn over the profits for public investment, not to line the pockets of private investors.

Without a doubt, what we need is a fully nationalized banking system.

WERC: Many of the initiators of the Workers Emergency Recovery Campaign are calling for the nationalization of the banks without compensation. They also say that the $700 billion in the Paulson plan — funds that are simply sitting in the banks waiting to ride out the recession — should be confiscated by the government and placed at the service of job creation.

Today, the government could nationalize the banks and use that $1 trillion in the PPIF fund — just to give one example — to put people back to work. If we assume a living wage of $50,000 per worker for one year, and we multiply this number by the 20 million projected unemployed workers, this gives us exactly $1 trillion. Shouldn't the Obama administration earmark that $1 trillion to provide unionized, living-wage jobs for one year to the 20 million unemployed? Isn't this a better way to jump-start the economy?

Rasmus: That's the point I have been making all along. People are referring to the Great Depression. But what got us out of the Depression? It was not the New Deal.

The New Deal did not really come on the scene till 1935, with some success. It stopped the decline, but it did not generate the recovery, and after two years, Roosevelt and others started dismantling the New Deal. Once they started doing this and trying to balance the budget, in mid-1937, we went right back into the Depression. We did not come out of the Depression till 1942. Why was this? It was because government spending, i.e., public investment, rose from 20 percent to 40 percent of annual Gross Domestic Product (GDP), the total annual spending in the economy.

WERC: How are they planning to finance the PPIF: Would it be through the Treasury?

Rasmus: Yes. They've got about $190 billion left over from that $700 billion TARP fund, and they will put in initially another $810 million, again, to subsidize the investors and the banks with the hope that they will come into the market to start buying and selling the bad assets at above the market price. They want to induce a market and a price, and they hope that once they do this, all the investors will step in and follow suit. But that's a big if. I don't see it coming.

Now the second part of the financial plan is designed to work in conjunction with the PPIF, and that's the TALF, or Term-Backed Securities Loan Facility. This will be run by the Federal Reserve.

The Fed had $200 billion assigned for this last November 2008, but it just held onto it. Now in about a week they are going to issue another $800 billion. So they'll have an addition $1 trillion for TALF.

WERC: Will this mean that the Federal Reserve will issue bonds for the TALF?

Rasmus: Not exactly. The idea is for Fed to lend money to investors, particularly investors in the hedge funds, money-marked mutual funds, and private equity funds — that is, to the shadow banks that are responsible for so much of the speculation that got us into the mess we're in today — so that they can buy the bad assets. As you see, they are coming at it from two directions.

But bad assets of what? The plan is to buy up the securitized bonds and loans associated with consumer credit. We are on the verge of another sub-prime-like bust in the consumer credit markets — meaning auto loans, student loans, credit card loans, and commercial property loans.

The whole idea here is that the Fed will loan money to hedge funds and private equity funds to buy these bad assets that are about to collapse. Estimates are that defaults on credit cards alone are going to rise from their current 2% to 3% today to 8% to 10%.

It's ironic, when you think about it, that the government is going to try to resurrect this thing through the shadow banking system and securitized markets, which collapsed from more than a trillion dollars in credit a few years ago and which have lost close to $4 trillion total.

The hedge funds have lost $1 trillion of their total value, and yet we are going to give them money to buy out all these bad assets … all of this to try to stimulate and increase the lending to industry, to commerce, and the like.

This doesn't make any sense. It just shows that the government has absolutely no confidence that the commercial banks can lead a recovery.

The question is, Is anyone going to re-enter into these securitized markets that have collapsed and buy up these bad assets, even with these government loans? Does anyone want to touch the toxic securitized markets? I don't think so. Even with loans … unless the government gives them interest-free loans — and if that happens, the government should just enter and take over these consumer credit markets and provide credit directly through the Fed the auto, student, commercial property and other markets. Let the Fed provide the funds directly to, for instance, credit unions as the local loaning institutions. Why have middle-men come in and skim off the profits?

We must also keep in mind that the $2 trillion they are throwing at the banks with this plan is just the beginning. Everyone is lining up at the trough for a taxpayer payout.

WERC: Let's talk now about Homeowner Affordability and Stability Plan, which is both the third financial package and the fourth component of the Obama recovery plan.

Rasmus: There are two parts to it. The first is $200 billion to go to Fannie Mae and Freddie Mac, because they already ran through the $200 billion we gave them back in August 2008. They have bought up the bad housing loans, or mortgage loans — and as their values continue to fall as housing prices fall, the values of the loans they bought up have collapsed. So they have run through their $200 billion, and they need $200 billion more.

It's not really going to improve anything when you just keep buying up these bad loans. That's the first part.

Regarding the second part, we have to keep in mind that Fannie Mae, Freddie Mac, and AIG, which is now supposedly "government owned," only constitute about 20% to 30% of the housing market. That leaves 70% to 80% of the bad housing mortgage market, which the government had not been addressing. It's this other portion that the Homeowner Affordability and Stability Plan now addresses — but with only $75 billion, a paltry sum!

And even this $75 billion is targeting subsidies to mortgage lenders; in other words, it's trickle-down once again — that is, give money to the mortgage lenders to have the government and taxpayers pay to lower the interest rates on new home loans — up to $75 billion, which is not all the many home loans.

And what's even more outrageous, these loans are to go to new buyers — not to those 5 million to 7 million homeowners who face foreclosure, delinquency, or default. The government is not attempting to do anything about people who are losing their homes. What they plan to do is subsidize the markets, so that the lenders can create new, affordable buyers to buy up some of the foreclosed homes.

This is a sop, a freebie, thrown to the mortgage lenders who are asked to come in buy some of the foreclosures and some of the huge stock of homes, to help them sell all the new homes. So really, it's a plan to benefit the mortgage lenders and construction firms holding all these new, unsold homes.

WERC: Now, let's get to the last item: the 2009 budget. This is the part that many are touting as New Deal and even "socialist," if we are to believe Rush Limbaugh.

Rasmus: This is a $3.6 trillion budget with a lot of spending. There is going to be a firestorm over it. Watch the Republicans, the corporations and the banking interests come out of the woodwork. The gloves are going to come off. This is where the big split in the capitalist class is going to reveal itself, because there are some proposals in this plan that would shift income. It's a shift that is insufficient, — too little too late, once again — but it is certainly moving in a better direction.

This is what we know so far about the budget:

It will increase taxes on the wealthiest 2% of households — but it will only increase taxes from 35% to 39.5%. This will effect people making more than $250,000 per year. This amounts to a rollback to the Clinton period. But that tax increase on the top-margin rate does not take effect until 2011, when the Bush tax cuts expire. This is absurd. It should take effect in 2009. They shouldn't be putting it off, when funding is needed so desperately to stop teacher layoffs, prevent home foreclosures, or to stop autoworker layoffs.

What's more, they will not come close to obtaining the funding they need for a real economic recovery by only rolling back the capital gains' and capital incomes' tax cuts only to the 1990s levels. They have to roll them back to the pre-Reagan, pre-1980s, rates. They have to raise these rates back to 50%, minimum.

So there is some increase in the tax rate, but it is delayed and it is far less than what is needed. Again, 2009 is a critical juncture year. If the declining situation is not reversed, the odds are increasing that we will be moving in 2010 to a global recession. There really is no way out without a real re-distribution of income, reversing the redistribution of income from workers to investors and corporations that has been going on since 1980.

Second, on healthcare. The budget calls for $634 billion in healthcare funding, but this is only half of what is needed for single-payer. Also, if this funding goes to the private insurance companies, as appears to be the case, there will be no real solution to the healthcare crisis in our country. Only single-payer offers a solution.

Third, the budget calls for deprivatizing student loans. This is one point that is commendable in the plan.

The details of the plan are only emerging. We will have to monitor it closely. But one thing is certain: What has been proposed by the Obama administration is likely to be modified substantially by the Republicans and centrist Democrats. There is going to be a big fight, with major changes expected.

WERC: The government is talking about incurring a $1.75 trillion deficit with this budget. What does this mean? How will the deficit be financed?

Rasmus: First, it should be noted that the real deficit by 2010 will be $2.25 trillion.

One way they are talking about financing this deficit is with carbon credits. These are carbon pollution permits. The government is expecting a $526 billion revenue from this source, though it's questionable whether they will be able to raise this amount. Governments and corporations in Europe want to give corporations credits for free. They'll try that here too.

They will issue more Treasury bonds, and they will simply have go to the printing presses and print more money. Clearly, they are in a bind — especially if the economy continues to tank.

WERC: You have made many predictions that have actually come true — unlike just about every mainstream economist and forecaster. What are your predictions today?

Rasmus: We're on the knife's edge of a transition between this epic recession and a depression. The bank bailout will require trillions more dollars. And even then, the impact is likely to be marginal.

The depression could be triggered by one or more of the following factors: sovereign debt crises in Eastern Europe, deepening job losses in the United States, the collapse of the treasuries' markets; the collapse of the global bond markets. These are among the many possible scenarios.

WERC: What is to be done?

Rasmus: I have outlined some policy recommendations here. Readers who would like to delve into this question in greater depth can get my full set of proposals on my website, which is www.kyklosproductions.com. You can also see my latest article in the March 2009 of "Z" magazine, where I describe my full set of proposals for recovery as an alternative to the Obama program.