Finance Capitalism Hits a Wall

The Oligarchs' Escape Plan – at the Treasury's Expense

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The financial "wealth creation" game is over. Economies emerged from World War II relatively free of debt, but the 60-year global run-up has run its course. Finance capitalism is in a state of collapse, and marginal palliatives cannot revive it. The U.S. economy cannot "inflate its way out of debt," because this would collapse the dollar and end its dreams of global empire by forcing foreign countries to go their own way. There is too little manufacturing to make the economy more "competitive," given its high housing costs, transportation, debt and tax overhead. A quarter to a third of U.S. real estate has fallen into Negative Equity, so no banks will lend to them. The economy has hit a debt wall and is falling into Negative Equity, where it may remain for as far as the eye can see until there is a debt write-down.

Mr. Obama's "recovery" plan based on infrastructure spending will make real estate fortunes for well-situated properties along the new public transport routes, but there is no sign of cities levying a windfall property tax to save their finances. Their mayors would rather keep the cities broke than to tax real estate and finance. The aim is to re-inflate property markets to enable owners to pay the banks, not to help the public sector break even. So state and local pension plans will remain underfunded while more corporate pension plans go broke.

One would think that politicians would be willing to do the math and realize that *debts that can't be paid, won't be*. But the debts are being kept on the books, continuing to extract interest to pay the creditors that have made the bad loans. The resulting debt deflation threatens to keep the economy in depression until a radical shift in policy occurs – a shift to save the "real" economy, not just the financial sector and the wealthiest 10% of American families.

There is no sign that Mr. Obama's economic advisors, Treasury officials and heads of the relevant Congressional committees recognize the need for a write-down. After all, they have been placed in their positions precisely because they do *not* understand that debt leveraging is a form of economic overhead, not real "wealth creation." But their tunnel vision is what makes them "reliable" to Wall Street, which doesn't like surprises. And the entire character of today's financial crisis continues to be labeled "surprising" and "unexpected" by the press as each new surprisingly pessimistic statistic hits the news. It's safe to be surprised; suspicious to have expected bad news and being a "premature doomsayer." One must have faith in the system above all. And the system *was* the Greenspan Bubble. That is why "Ayn Rand Alan" was put in charge in the first place, after all.

So the government tries to recover the happy Bubble Economy years by getting debt growing again, hoping to re-inflate real estate and stock market prices. That was, after all, the Golden Age of finance capital's world of using debt leverage to bid up the book-price of fictitious capital assets. Everyone loved it as long as it lasted. Voters thought they had a chance to become millionaires, and approved happily. And at least it made Wall Street richer than ever before – while almost doubling the share of wealth held by the wealthiest 1% of America's families. For Washington policy makers, they are synonymous with "the economy" – at least the economy for which national economic policy is being formulated these days.

The Obama-Geithner plan to restart the Bubble Economy's debt growth so as to inflate asset prices by enough to pay off the debt overhang out of new "capital gains" cannot possibly work. But that is the only trick these ponies know. We have entered an era of asset-price deflation, not inflation. Economic data charts throughout the world have hit a wall and every trend has been plunging vertically downward since last autumn. U.S. consumer prices experienced their fastest plunge since the Great Depression of the 1930s, along with consumer "confidence," international shipping, real estate and stock market prices, oil and the exchange rate for British sterling. The global economy is falling into depression, and cannot recover until debts are written down.

Instead of doing this, the government is doing just the opposite. It is proposing to take bad debts onto the public-sector balance sheet, printing new Treasury bonds give the banks – bonds whose interest charges will have to be paid by taxing labor and industry.

The oligarchy's plans for a bailout (at least of its own financial position)

In periods of looming collapse, wealthy elites protect their funds like rats fleeing a sinking ship. In times past they bought gold when currencies started to weaken. (Patriotism never has been a characteristic of cosmopolitan finance capital.) Since the 1950s the International Monetary Fund has made loans to support Third World exchange rates long enough to subsidize capital flight. In the United States over the past half-year, bankers and Wall Street investors have tapped the Treasury and Federal Reserve to support prices of their bad loans and financial gambles, buying out or guaranteeing $12 trillion of these junk debts. Protection for the U.S. financial elite thus takes the form of domestic public debt, not foreign currency.

It is all in vain as far as the real economy is concerned. When the Treasury gives banks newly printed government bonds in "cash for trash" swaps, it leaves today's unpayably high private-sector debt in place. All that happens is that this debt is now owed to (or guaranteed by) the government, which will have to impose taxes to pay the interest charges.

The new twist is a variant on the IMF "stabilization" plans that lend money to central banks to support their currencies – for long enough to enable local oligarchs and foreign investors to move their savings and investments offshore at a good exchange rate. The currency then is permitted to collapse, enabling currency speculators to rake in enough gains to empty out the central bank's reserves. Speculators view these central bank holdings as a target to be raided – the larger the better. The IMF will lend a central bank, say, $10 billion to "support the currency." Domestic holders will flee the currency at a high exchange rate. Then, when the loan proceeds are depleted, the currency plunges. Wages are squeezed in the usual IMF austerity program, and the economy is forced to earn enough foreign exchange to pay back the IMF.

As a condition for getting this kind of IMF "support," governments are told to run a budget surplus, cut back social spending, lower wages and raise taxes on labor so as to squeeze out enough exports to repay the IMF loans. But inasmuch as this kind "stabilization plan" cripples their domestic economy, they are obliged to sell off public infrastructure at distress prices – to foreign buyers who themselves borrow the money. The effect is to make such countries even more dependent on less "neoliberalized" economies.

Latvia is a poster child for this kind of disaster. Its recent agreement with Europe is a case in point. To help the Swedish banks withdraw their funds from the sinking ship, EU support is conditional on Latvia's government agreeing to cut salaries in the private sector – and not to raise property taxes (currently almost zero).

The problem is that Latvia, like other post-Soviet economies, has scant domestic output to export. Industry throughout the former Soviet Union was torn up and scrapped in the 1990s. (Welcome to victorious finance capitalism, Western-style.) What they had was real estate and public infrastructure free of debt – and hence, available to be pledged as collateral for loans to finance their imports. Ever since its independence from Russia in 1991, Latvia has paid for its imported consumer goods and other purchases by borrowing mortgage credit in foreign currency from Scandinavian and other banks. The effect has been one of the world's biggest property bubbles – in an economy with no means of breaking even except by loading down its real estate with more and more debt. In practice the loans took the form of mortgage borrowing from foreign banks to finance a real estate bubble – and their import dependency on foreign suppliers.

So instead of helping it and other post-Soviet nations develop self-reliant economies, the West has viewed them as economic oysters to be broken up to indebt them in order to extract interest charges and capital gains, leaving them empty shells. This policy crested on January 26, 2009, when Joaquin Almunia of the European Commission wrote a letter to Latvia's Prime Minister spelling out the terms on which Europe will bail out the Swedish and other foreign banks operating in Latvia – at Latvia's own expense:

Extended assistance is to be used to avoid a balance of payments crisis, which requires … restoring confidence in the banking sector [now entirely foreign owned], and bolstering the foreign reserves of the Bank of Latvia. This implies financing … outstanding government debt repayments (domestic and external). And if the banking sector were to experience adverse events, part of the assistance would be used for targeted capital infusions or appropriate short-term liquidity support. However, financial assistance is not meant to be used to originate new loans to businesses and households. …

… it is important not to raise ungrounded expectations among the general public and the social partners, and, equally, to counter misunderstandings that may arise in this respect. Worryingly, we have witnessed some recent evidence in Latvian public debate of calls for part of the financial assistance to be used *inter alia* for promoting export industries or to stimulate the economy through increased spending at large. It is important actively to stem these misperceptions.

Riots broke out last week, and protesters stormed the Latvian Treasury. Hardly surprising! There is no attempt to help Latvia develop the export capacity to cover its imports. After the domestic kleptocrats, foreign banks and investors have removed their funds from the economy, the Latvian lat will be permitted to depreciate. Foreign buyers then can come in and pick up local assets on the cheap once again.

The practice of European banks riding the crest of the post-Soviet real estate bubble is backfiring to wreck the European economies that have engaged in this predatory lending to neighboring economies as well. As one reporter has summarized:

In Poland 60 percent of mortgages are in Swiss francs. The zloty has just halved against the franc. Hungary, the Balkans, the Baltics, and Ukraine are all suffering variants of this story. As an act of collective folly – by lenders and borrowers – it matches America's sub-prime debacle. There is a crucial difference, however. European banks are on the hook for both. US banks are not. Almost all East bloc debts are owed to West Europe, especially Austrian, Swedish, Greek, Italian, and Belgian banks.1

This was the West's alternative to Stalinism. It did not help these countries emulate how Britain and America got rich by protectionist policies and publicly nurtured industrialization and infrastructure spending. Rather, the financial rape and industrial dismantling of the former Soviet economies was the most recent exercise in Western colonialism. At least U.S. investors were smart enough to stand clear and merely ride the stock market run-up before jumping ship.

But now, the government's plan to "save" the economy is to "save the banks," along similar lines to the West trying to save its banks from their adventure in the post-Soviet economies. This is the basic neoliberal economic plan, after all. The U.S. economy is about to be "post-Sovietized."

The U.S. giveaway to banks, masquerading as "help for troubled homeowners"

The Obama bank bailout is arranged much like an IMF loan to support the exchange rate of foreign currency, but with the Treasury supporting financial asset prices for U.S. banks and other financial institutions. Instead of banks and oligarchs abandoning the dollar, the aim is to enable them to dump their bad mortgages and CDOs and get domestic Treasury bonds. Private-sector debt will be moved onto the U.S. Government balance sheet, where "taxpayers" will bear losses – mainly labor not Wall Street, inasmuch as the financial sector has been freed of income-tax liability by the "small print" in last autumn's Paulson-Bush bailout package. But at least the U.S. Government is handling the situation entirely in domestic dollars.

As in Third World austerity programs, the effect of keeping the debts in place at the "real" economy's expense will be to shrink the domestic U.S. market – while providing opportunities for hedge funds to pick up depreciated assets cheaply as the federal government, states and cities sell them off. This is called letting the banks "earn their way out of debt." It's strangling the "real" economy, because not a dollar of the government's response has been devoted to reducing the overall debt volume.

Take the much-vaunted $50 billion program designed to renegotiate mortgages downward for "troubled homeowners." Upon closer examination it turns out that the real beneficiaries are the giant leading banks such as Citibank and Bank of America that have made the bad loans. The Treasury will take on the bad debt that banks are stuck with, and will permit mortgagees to renegotiate their monthly payment down to 38% of their income. **But rather than the banks taking the loss as they should do for over-lending, the Treasury itself will make up the difference – and pay it to the banks so that they**

will be able to get what they hoped to get. The hapless mortgage-burdened family stuck in their negative-equity home turns out to be merely a passive vehicle for the Treasury to pass debt relief on to the commercial banks.

Few news stories have made this clear, but the *Financial Times* spelled the details buried in small print.2 It added that the Treasury has not yet decided whether to write down the debt principal for the estimated 15 million families with negative equity (and perhaps 30 million by this time next year as property prices continue to plunge). No doubt a similar deal will be made: For every $100,000 of write-down in debt owed by over-mortgaged homeowners, the bank will receive $100,000 from the Treasury. Government debt will rise by $100,000, and the process will continue until the Treasury has transferred $50,000,000 to the banks that made the reckless loans.

There is enough for just 500 of these renegotiations of $100,000 each. Hardly enough to make much of a dent, but the principle has been put in place for many further bailouts. It will take almost an infinity of them, as long as the Treasury tries to support the fiction that "the miracle of compound interest" can be sustained for long. The danger is the economy may be dead by the time saner economic understanding penetrates the public consciousness. In the mean time, bad private-sector debt will be shifted onto the government's balance sheet. Interest and amortization currently owed to the banks will be replaced by obligations to the U.S. Treasury. Taxes will be levied to make up the bad debts with which the government is stuck. The "real" economy will pay Wall Street – and will be paying for decades!

Calling the $12 trillion giveaway to bankers a "subprime crisis" makes it appear that bleeding-heart liberals got Fannie Mae and Freddie Mac into trouble by insisting that these public-private institutions make irresponsible loans to the poor. The party line is, "Blame the victim." But we know this is false. The bulk of bad loans are concentrated in the largest banks. It was Countrywide and other banksters that led the irresponsible lending and brought heavy-handed pressure on Fannie Mae. Most of the nation's smaller, local banks didn't make such reckless loans. The big mortgage shops didn't care about loan quality, because they were run by salesmen. The Treasury is paying off the gamblers and billionaires by supporting the value of bank loans, investments and derivative gambles, leaving the Treasury in debt.

U.S./post-Soviet Convergence?

It may be time to look once again at what Larry Summers and his Rubinomics gang did in Russia in the mid-1990s and to Third World countries during his tenure as World Bank economist to see what kind of future is being planned for the U.S. economy over the next few years. Throughout the Soviet Union the neoliberal model established "equilibrium" in a way that involved demographic collapse: shortening life spans, lower birth rates, alcoholism and drug abuse, psychological depression, suicides, bad health, unemployment and homelessness for the elderly (the neoliberal mode of Social Security reform).

Back in the 1970s, people speculated whether the US and Soviet economies were converging. Throughout the 20th century, of course, everyone expected government regulation, infrastructure investment and planning to increase. It looked like the spread of democratically elected governments would go hand in hand with people voting in their own economic interest to raise living standards, thereby closing the inequality gap.

This is not the kind of convergence that has occurred since 1991. Government power is being dismantled, living standards have stagnated and wealth is concentrating at the top of the economic pyramid. Economic planning and resource allocation has passed into the hands of Wall Street, whose alternative to Hayek's "road to serfdom" is debt peonage for the economy at large. There does need to be a strong state, to be sure, to keep the financial and real estate *rentier* power in place. But the West's alternative to the old Soviet bureaucracy is a financial planning. In place of a political overhead, we have a financial and real estate overhead.

Stalinist Russia and Maoist China achieved high technology without land-rent, monopoly rent and interest overhead. This purging of *rentier* income was the historical task of classical political economy, and it became that of socialism. The aim was to create a Clean Slate financially, bringing prices in line with technologically necessary costs of production. The aim was to provide everyone with the fruits of their labor rather than letting banks and landlords siphon off the economic surplus.

Ideas of economic efficiency and "wealth creation" today are an utterly different kind of liberalism and "free markets." Commercial banks lend money not to increase production but to inflate asset prices. Some 70% of bank loans are mortgage loans for real estate, and most of the rest is for corporate takeovers and raids, to finance stock buy-backs or simply to pay dividends. Asset-price inflation obliges people to go deeper into debt than ever before to obtain access to housing, education and medical care. The economy is being "financialized," not industrialized. This has been the plan as much for the post-Soviet states as for North America, Western Europe and the Third World.

But we are far from having reached the end of the line. Celebrations that our present financialized economy represents the "end of history" are laughingly premature. Today's policies look more like a dead end. But that does not mean that, like the Roman Empire, they won't lead us down toward a new Dark Age. That's what tends to happen when oligarchies do the planning.

Is America a Failed Economy?

It may be time to ask whether neoliberal pro-*rentier* economics has turned America and the West into a Failed Economy. Is there really no alternative? Have the neoliberals made the shift of planning from governments to the financial oligarchy irreversible?

Let's first dispose of the "foundation myth" of the idea still guiding the United States and Europe. Free-market economists pretend that prices can be brought into line most efficiently with technologically necessary costs of production under capitalism, and indeed, under finance capitalism. The banks and stock market are supposed to allocate resources most efficiency. That at least is the dream of self-regulating markets. But today it looks like only a myth, public relations patter talk to get a generation of increasingly indebted voters not to act in their own self-interest.

Industrial capitalism always has been a hybrid, a symbiosis with its feudal legacy of absentee property ownership, oligarchic finance and public debts rather than the government acting as net creditor. The essence of feudalism was extractive, not productive. That is why it created industrial capitalism as State Policy in the first place – if only to increase its war-making powers. But the question must now be raised as to whether only socialism can complete the historical task that classical political economy set out for itself –

the ideal that futurists in the 19th and 20th centuries believed that an unpurified capitalism might still be able bring about without shedding its legacy of commercial banking indebting property and carving infrastructure out of the public domain.

Today it is easier to see that the Western economies cannot go on the way they have been. They have reached the point where the debts exceed the ability to pay. Instead of recognizing this fact and scaling debts back into line with the ability to pay, the Obama-Geithner plan is to bail out the big banks and hedge funds, keeping the volume of debt in place and indeed, growing once again through the "magic of compound interest." The result can only be an increasingly extractive economy, until households, real estate and industrial companies, states and cities, and the national government itself is driven into debt peonage.

The alternative is a century and a half old, and emerged out of the ideals of the classical economic doctrines of Adam Smith, David Ricardo, John Stuart Mill, and the last great classical economist, Marx. Their common denominator was to view rent and interest are extractive, not productive. Classical political economy and its successor Progressive Era socialism sought to nationalize the land (or at least to fully tax its rent as the fiscal base). Governments were to create their own credit, not leave this function to wealthy elites via a bank monopoly on credit creation. So today's neoliberalism paints a false picture of what the classical economists envisioned as free markets. They were markets free of economic rent and interest (and taxes to support an aristocracy or oligarchy). Socialism was to free economies from these overhead charges. Today's Obama-Geithner rescue plan is just the reverse.

NOTES

1 Ambrose Evans-Pritchard, "If Eastern Europe falls, world is next," *The Telegraph*, February 14, 2009.

2 Krishna Guha, "US closes in on subsidy plan to stop foreclosures," *Financial Times*, February 13, 2009.