The Obama “Dream Team”: Rubin-clones and political fakery

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Things are getting crazier by the day. On Tuesday, Treasury Secretary Henry Paulson announced that the Fed would commit another $800 billion to fight the financial crisis which has spread to the broader economy and is causing sharp declines in consumer spending. The Fed plans to buy $600 billion of mortgage-backed securities (MBS) from Fannie Mae and Freddie Mac and another $200 billion of Triple A bonds from non-bank financial companies that provide financing for consumers. There’s just one little glitch, Fannie and Freddie are already owned by the government, so buying the bad paper is like moving the figures from one ledger to another. It’s pointless. Except for the fact, that by shuffling the paperwork, Bernanke can drive down long-term interest rates and (hopefully) rekindle flagging home sales. It’s a parlour trick.

And with the other $200 billion he can kick-start the securitization market by purchasing bundles of student loans, credit cards and car loans. Investors have been boycotting the asset-backed securities (ABS) markets for months now which has choked off the flow credit to consumers. So the Fed is trying to unclog the plumbing by stepping in as the lender of last resort. Of course, if the Fed really wanted to get money to consumers, there are much easier ways to do it, like cutting the payroll tax, mailing out stimulus checks or issuing tax rebates to couples making under $60,000 per year. But that’s not the objective. What Bernanke really wants to do is to rev up securitization again because that’s the vehicle the investment banks and hedge funds use to increase profits through leveraged bets on odd-sounding derivatives. (CDO, MBS, CDS). BFor now, no one is buying dodgy securities because no one knows they’re really worth. Until that can be worked out, investors will stay away. That’s why it would be better to cut back on the liquidity and work harder on transparency. Price discovery for structured investments is critical. If investors think that prices are reliable, then they’ll jump back in. If not; it’s no dice.

Bernanke and Paulson are trying to tackle the financial crisis from the wrong end. This isn’t about liquidity or “access to credit”, its about confidence. The public’s trust has been betrayed a million times over. They’ve been tricked with WMD, bamboozled with phantom enemies, and cheated with bogus securities. All the surveys say the same thing; public confidence is at an all-time low. As a result, fear and pessimism are more widespread than any time in recent history. People no longer expect tomorrow to be better than today. In fact, they expect it to be worse, and for good reason. The country has broken loose from its moorings and is adrift. There’s no accountability at any level of government. It doesn’t matter how big or heinous the crime, no one pays. The justice system is a sham. In fact, the D.O.J. is just a weapon for destroying political enemies; that’s it. The one noteworthy conviction in the last 8 years was home-decorating guru Martha Stewart. What a joke. In his memoirs, Bush can boast, “At least we got Martha Stewart off the streets.”

And it’s not just the justice system that lacks credibility either; it’s the financial system, too. The stampede out of the stock market to US Treasurys shows how quickly trust can turn to panic. The downward spiral of the economy reflects the mood of the country; dark and gloomy. That’s not something that can be changed with more liquidity. After all, the economy is more than the sum of its parts, just like people are more than just consumption machines that can be zapped like rats into spending themselves into oblivion. They’re sentient beings who can see the deteriorating economic conditions closing in on them and threatening their security. They’re scared. Bernanke–the academic–sees the economy through the lens of his research on the Great Depression. He, like many other monetarists, believe that the depression was the result of the one-third contraction in the money supply during the 1930s. It is a widely held view and it could be true. But if that’s the case, than why haven’t the Fed’s myriad lending facilities–which have flooded the financial system with trillions of dollars of liquidity–stopped the markets from crashing and the recession from deepening. Could it be that there are other factors involved besides money supply?

People are hunkering down for a reason, and its not just lost revenue. They’ve lost faith in their institutions–the government, the banks, and the media; everybody is in it for themselves, and it shows. Even now, with the economy teetering at the brink of disaster, high-ranking officials like Paulson are still diverting hundreds of billions of dollars from the Treasury to their Wall Street buddies leaving nothing behind but a few scraps for the working stiffs. And Paulson isn’t alone either; his Darwinian “dog eat dog” creed is the prevailing ethos of the corrupt oligarchy that runs the country, Republican and Democrat alike, it makes no difference. It’s “me first” and the public be damned.

If Bernanke really wants to know how the economy is doing, he should pay a visit to any town or city in America. Business is off everywhere; it’s not just retail. The restaurants, the gas stations, the dry cleaners; even the casinos are hurting. The lines at the food banks are longer than the unemployment lines, and the only business that’s booming is the pawn shops where the family silver is traded away for gas money or a few bucks to blow on groceries. This is what recession looks like from the ground floor where people are struggling to just make ends meet. No more 3-course dinners at Olive Garden and no more $5.25 lattes and cranberry scones at Starbucks. It’s Campbells for lunch, Spam for dinner and plenty of wool blankets for evening TV.

Does Paulson think he can “turn off” the public’s pessimism like a light switch?
Does Bernanke think he can get people to spend themselves further into debt by lowering interest rates?
It can’t be done. And the Obama camp is going to run into the same brick wall. The nation’s confidence has been shattered and people are developing a bunker mentality.

The truth is, Obama was shoehorned into the White House because the ruling elite saw that the country was slipping into a consumer-led depression. They needed a bright new face to restore confidence and spark optimism during the tough times ahead. But now that he’s been elected, they’ve surrounded him with the same men who created the present crisis. Lawrence Summers pushed for the repeal of the laws which prevented commercial banks from merging with the Wall Street casinos and he also helped to deregulate derivatives trading which now threatens to bring down the entire financial system if a major player, like Citigroup, goes under.

Timothy Geithner and Lawrence Summers were central figures in the bubble-driven growth and deregulation mania of the last decade. Their influence factored heavily into the speculation that was brought on by low interest rates, easy credit and massive leverage; the lethal combo that created the present crisis. Their elevation to the top positions in the administration –along with Paul Volcker–proves that the Obama presidency is just more political fakery; a charming and charismatic figurehead placed in front of the executive podium to conceal the machinations of deeply-entrenched interests who are busy rebuilding the trickle-down system from the ground up. There's nothing new here, and certainly nothing progressive. The much-celebrated "Dream Team" is an amalgam of Rubin-clones who used Obama as a land-bridge to the White House to strengthen the status quo and get on with the task of shifting the nation's wealth to Wall Street's economic royalists.

The fact is, the Obama star-studded economic recovery team emerges from the same ideological petris-dish as Bernanke and Paulson. Their world view is shaped by the same strong sense of entitlement which will prevent them from enacting the regulatory reforms that need to be put in place to restore transparency, confidence and credibility. Instead, they will unleash a torrent of stimulus (infrastructure and green technology mainly) followed by unorthodox monetarist/fiscal chicanery (like purchasing stocks on the equities market or buying long-term Treasurys) all of which will hide the fact that they are not forcing the bad debts out into the open so they can be written down and the markets can reestablish equilibrium.

No one disputes that Geithner, Summers and Volcker are smarter and more competent than Team Bush, and that, their Keynesian plan to inject massive doses of stimulus into the economy will have a positive effect. But that's as far as it goes. The men behind these remedies are limited by institutional loyalties that will keep them from overhauling the system in meaningful way. Neither Summers, nor Geithner nor Volcker would ever dare to tamper with the revenue-producing system which maintains the orderly division between rich and poor. That just won't happen.

So, after the fanfare subsides and Obama's economic team puts its stimulus plan in motion, there should be some marginal uptick in economic activity. But unless the underlying problems are addressed, there's little hope of any lasting recovery. The banks need to take their medicine and write down the losses. Regulators have to decide which institutions are solvent and can be saved, and which are underwater and will have to be shut down. The Obama administration will have to open a bank morgue, like the Resolution Trust Corporation (RTC), so the bad assets from failed banks can be sold at auction to the highest bidder. That's the only way to put this whole mess behind us and start to dig out. Putting the securities up for bid will restore confidence and, eventually, lure investors back into the stock market. It will also remove the zombie banks from hanging on and depending on government bailouts. There's a method for unwinding sick banks through restructuring debt. It needs to be put to use.

Regardless of what the new administration does, the stock markets will take another leg down between the end of 2009 to early 2010, finding a bottom on the Dow of 4,500 or thereabouts (70% plus declines took place on the NASDAQ following the dot.com bust, Japan during the 1990s "lost decade" and the Great Depression. In none of these cases was the bottom reached in the first year) Hedge fund redemptions will force more deleveraging and more wild swings on the stock market. The banks–which have accounted for nearly half of their losses–will need to write off another $800 to $900 billion before they see daylight. It's a long uphill slog and no one knows where they'll get the capital. Unemployment will skyrocket, housing will overshoot to the downside, and there will be the first random incidents of political instability (and rioting) in major US cities. The economy will be flat on its back for some years into the future. How quickly the markets rebound depends largely on how fast Obama's team is able to grasp that the system needs deep structural change and a banking system that is not paralyzed with debt.