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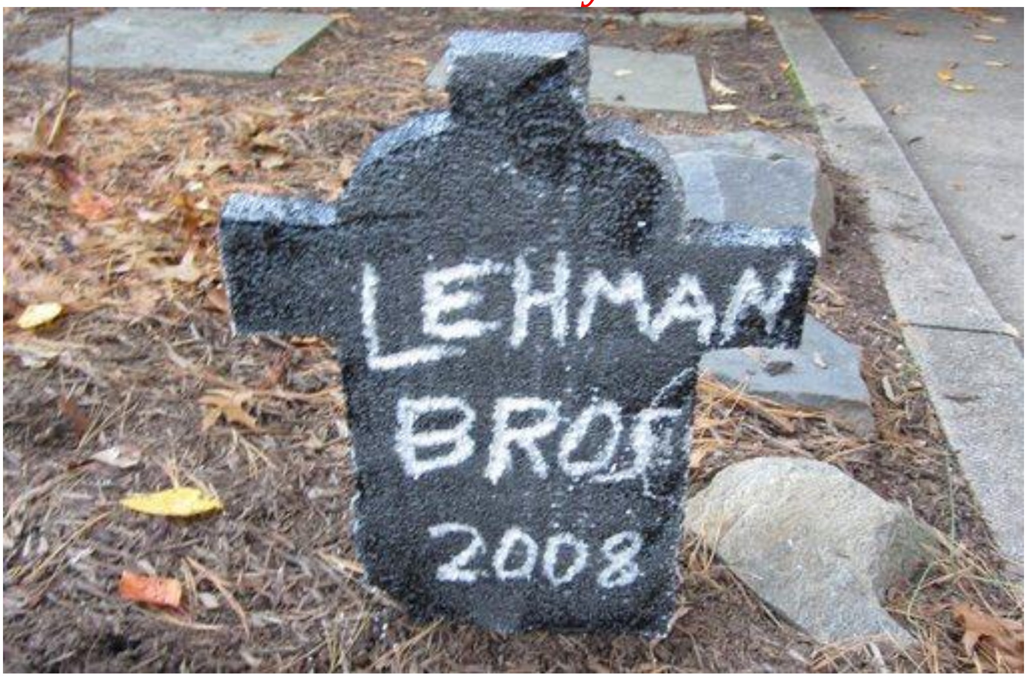
Wasting the Lehman Crisis: What Was Not Saved Was the Economy



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Today's financial malaise for pension funds, state and local budgets and underemployment is largely a result of the 2008 bailout, not the crash. What was saved was not only the banks – or more to the point, as Sheila Bair pointed out, their bondholders – but the financial overhead that continues to burden today's economy.

Also saved was the idea that the economy needs to keep the financial sector solvent by an exponential growth of new debt – and, when that does not suffice, by government purchase of stocks and bonds to support the balance sheets of the wealthiest layer of society. The internal contradiction in this policy is that debt deflation has become so overbearing and dysfunctional that it prevents the economy from growing and carrying its debt burden.

Trying to save the financial overgrowth of debt service by borrowing one's way out of debt, or by monetary Quantitative Easing re-inflating real estate, stock and bond prices, enables the creditor One Percent to gain, not the indebted 99 Percent in the economy at large. Therefore, from the economy's vantage point, instead of asking how the banks are to be saved "next time," the question should be, how should we best let them go under – along with their stockholders, bondholders and uninsured depositors whose hubris imagined that their loans (other peoples' debts) could go on rising without impoverishing society and preventing creditors from collecting in any event – except from government by gaining control over it.

A basic principle should be the starting point of any macro analysis: The volume of interest-bearing debt tends to outstrip the economy's ability to pay. This tendency is inherent in the "magic of compound interest." The exponential growth of debt expands by its own purely mathematical momentum, independently of the economy's ability to pay – and faster than the non-financial economy grows.

The higher the debt/income ratio rises, the more interest, amortization payments and late fees are extracted from the economy. The resulting debt burden slows the economy, causing defaults. That is what happened in 2008, and is accelerating today as debt ratios are rising for corporate debt, state and local debt, and student debt.

Neither legislators, academics nor the public at large recognize a corollary Second Principle following from the first: An over-indebted economy cannot be saved *unless* the banks fail. That means writing down the financial claims by the One to Ten Percent – in other words, the net debts owed by the 99 to 90 Percent. Wiping out bad debts involves writing down the "bad savings" that are the counterpart to these debts on the asset side of the balance sheet. Otherwise the economy will suffer debt deflation and austerity.

"Recovery" since 2008 has been much slower than earlier recoveries because debt deflation is siphoning off more and more personal and corporate income. To make matters worse, the bailout's policy of Quantitative Easing to re-inflate asset prices has reduced rates of return for pension funds, insurance companies and employee retirement savings. This means that more state and local government income must be diverted to meet retirement commitments.

Something has to give, and it is not likely to be the savings of the donor class at the top of the economic pyramid. As a result, the economy at large is threatened with an exponentially expanding erosion of disposable income and net worth for most people and companies. Investment managers are warning of a financial meltdown, given today’s historically high price/earnings ratios for stocks and also for rental properties.

What is not acknowledged is that such a crisis is a precondition for today’s economy to recover from the rising debt/income and debt/GDP ratios that are burdening the United States, Europe and other regions. At least the United States has been able to monetize its budget deficits and subsidize banks to carry its rising debt overhead with yet new debt. The Eurozone has banned budget deficits of over 3 percent of GDP, imposing austerity that leaves the only response to over-indebtedness to be Greek-style austerity: depopulation, shrinking living standards, wipeouts of retirement income and pensions, mortgage defaults, shortening lifespans, and mass selloffs of public infrastructure to foreign financial appropriators.

None of this was spelled out in the September 15 weekend marking the tenth anniversary of Lehman Brothers’ failure and subsequent rescue of Wall Street. President Obama, Treasury Secretary Tim Geithner and their fellow financial lobbyists at the Federal Reserve and Justice Department are credited with saving “the economy,” as if their donor class on Wall Street was a good proxy for the economy at large. “Saving the economy from a meltdown” has become the euphemism for saving bondholders and other members of the One Percent from taking losses on their bad loans. The “rescue” is Orwellian doublespeak for expropriating over nine million indebted Americans from their homes, while leaving surviving homeowners saddled with enormous bubble-mortgage payments to the FIRE sector’s owners.

What has been put in place is not a restoration of traditional status quo, but a reversal of over a century of central bank policy. Failed banks have not been taken into the public domain. They have been enriched far beyond their former levels. The perpetrators of the collapse have been rewarded, not penalized for lending more than could possibly be paid by NINJA borrowers and speculators whose mortgage applications were doctored by systemic fraud at Countrywide, Washington Mutual, Bank of America, Citigroup and their cohorts.

The $4.3 trillion that could have been used to save debtors was given to the banks and Wall Street firms whose recklessness and outright fraud caused the crisis. The Federal Reserve “cash for trash” swaps with insolvent banks did not restore normalcy or the *status* *quo ante*. What occurred was a financial revolution by stealth, reversing the traditional responsibility of creditors to make prudent loans.

Quantitative Easing saved creditors and the largest stockholders and bondholders by lowering the interest rates by enough to make it profitable for new loans to inflate asset prices on credit. This revived the value of collateral backing bank loans and bondholdings. "Saving" the economy in this way actually sacrificed it. That is why our "recovery" is only "on paper," a result of calculating GDP to include bank earnings and hypothetical homeowner windfalls as rents are soaring.

Among Democrats, the most extreme tunnel vision denying that debt is a problem comes from Paul Krugman: Writing that "The purely financial aspect of the crisis was basically over by the summer of 2009,"[1]he criticized what he called the "bizarre Beltway consensus that despite high unemployment and record low interest rates, debt, not jobs, was the real problem."

This misses the point that 2009 was the real beginning for most of the nine million homeowners being foreclosed on and evicted from their homes. Consumers found themselves with less income "freely disposable" after paying their monthly FIRE sector nut off the top of their paycheck – housing charges, credit card charges, medical insurance, student debt, FICA withholding and tax withholding. Krugman says that he would have solved the problem by more deficit spending to pump enough money into the economy to enable debtors to keep paying the banks their exponential growth of interest claims.

We are still living in the destabilized, debt-ridden aftermath of such pro-bank advocacy. In the *New Yorker*, John Cassidy celebrates a book by Columbia professor Adam Tooze promoting the idea that "the economy" cannot exist without the credit (that is, debt) provided by the financial sector.[2]True enough, but does it follow that rescuing the economy must involve rescuing Wall Street and enriching the banks at the expense of the rest of the economy. That conflation is an Orwellian rhetoric of deception that has been introduced to the discussion of how the economy was "rescued" by locking in today's Great Debt Deflation.

At the neoliberal/neocon Brookings Institution, Treasury secretaries Hank Paulson and Tim Geithner joined with the Federal Reserve's Ben Bernanke to explain that the public simply didn't understand how successful they all were in saving not only the banks, but non-bank financial institutions. Unlike Sheila Bair, they did not point out that behind these institutions were the bondholders, the One Percent of savers who held the rest of the economy in debt. Bernanke wrote a *Financial Times*piece producing junk statistics purporting to show that there was no underlying debt or financial problem at all, merely a "panic."[3] To paraphrase, he said: "The crisis was all in the mind folks. Nothing to see here. Keep moving on." It is as if, as Margaret Thatcher liked to insist, There Is No Alternative.

Can this bailout without debt writedowns really bring prosperity? Can economies achieve growth by "borrowing their way out of debt," by creating enough new credit to cover the interest charges out of capital gains from the asset-price inflation fueled by new bank credit. That is the logic that has guided the Federal Reserve's net $4.3 trillion in Quantitative Easing, and the parallel credit creation by the European Central Bank under Mario "Whatever it takes" Draghi. Ellen Brown recently published a review, "Central Banks Have Gone Rogue, Putting Us All at Risk, noting that the ECB has become a major stock buyer.[4]The beneficiaries are the stockholders who are concentrated in the wealthiest percentiles of the population. Governments are not underwriting homeownership or the solvency of labor's pension plans, but are underwriting the value of collateral backing the savings of the narrow financial class.

The GDP accounts report the widening gap between low government bond rates and the cost of credit to banks compared to the higher rates paid by mortgage borrowers, credit-card holders and student loan customers as "financial services." What is extracted from the economy is added to the GDP statistic instead of being treated as a subtrahend. This absurd practice reflects the degree to which Wall Street lobbyists have captured economic statistics. The National Income and Product Accounts (NIPA) have been turned into a vehicle for deception. What is celebrated as growth of the GDP since 2008 has been mainly the growth in financial extraction, along with the health-insurance sector profiting from Obamacare.

Glenn Hubbard, chairman of the Council of Economic Advisors under George W. Bush, uses Orwellian doublethink to pretend that "Debt is Wealth." He concludes a *Wall Street Journal* op-ed: "An ability to recapitalize banks remains crucial and must be explained to a skeptical Congress and public,"[5] so that wealthy bondholders and speculators will not suffer losses.

On a brighter side, Adair Turner pokes fun at the "Authoritative experts such as the IMF [who] explained how increased securitisation and trading activity made the financial system more efficient and less risky."[6] It was as if "options" and hedges can get rid of risk entirely, not shift them onto Wall Street victims such as the naïve German Landesbanks.

The aim of this week's disinformation campaign is to prevent popular anger advocating what was done in classical antiquity. The ancients fought civil wars for land redistribution and debt cancellation. Today the demand should be for mortgage writedowns to bring their carrying charges in line with reasonable rent charges, limited to the former normal 25 percent of homeowner income – while rolling back the FICA wage withholding and allied taxes levied to bail out the creditor class.

An Athenian antecedent to today's financial takeover

It is an old story, with a striking parallel in classical Athens. After losing the Peloponnesian war to oligarchic Sparta in 404, a Pinochet-style military junta – the Thirty Tyrants – was installed. During its eight months of terror its members killed a reported 1,500 democratic advocates whose land and other property they grabbed. Advocates of democracy took refuge in Thrace and other neighboring regions.

After the exiled democratic leaders reconquered Athens, they sought to restore harmony, going so far as to pay off all the debts that the oligarchic junta had run up to Sparta. To top matters, the subsequent 4th century obliged Athenian jurors and indeed, mayors in some Greek cities to swear an oath: "I will not allow private debts (*chreon idiom*) to be cancelled, nor lands nor houses of Athenian citizens to be redistributed."[7]

If no such pledge is needed today by public officials, it is because the financial administrators at the Treasury, Federal Reserve and other regulatory agencies already have shown themselves to be so tunnel-visioned from graduate school through their employment history that they can be trusted to find debt writedowns as unthinkable as enforcing laws against criminal financial fraud to punish individuals rather than their institutions. Academia joins in the deception that financial engineering can sustain a geometric growth in debt *ad infinitum* without imposing austerity. The bailout aftermath has demonstrated that corporations are not really "persons" if they cannot be given jail time.

The key financial principle is that this self-expansion of interest-bearing debt grows to absorb more and more of the economic surplus. The solution therefore must involve wiping out the excess debt – and savings that have been badly lent. That is what crashes are supposed to do. It was not done in 2008. That is why the status quo was not restored. A vast giveaway to the financial elites occurred, setting the rest of the economy on a road to debt peonage.

It would have been nice to have read an article by Sheila Bair explaining the procedures that the FDIC had in place, ready to take over insolvent Citigroup and other banks in similar straits, saving all the insured depositors by taking over these institutions. No doubt as public institutions they would not have indulged in junk mortgages or, for that matter, takeover loans.

It would have been nice to hear from Hank Paulson and perhaps Barney Frank on how they tried to get incoming President Obama to write down bad mortgages whose carrying charges were as far above the debtor's ability to pay as they were above the going rental value for similar properties. It would have been nice to hear a *mea culpa* from Mr. Obama apologizing for representing the interest of his campaign donors by standing between them and his voters with pitchforks. Even an article by Tim Geithner or Eric Holder on how lucky they felt at getting such high-paying jobs after they left office from the financial sector they had overseen and "regulated."

What is needed now is to follow up the primary policy perception that today's financially dysfunctional economy cannot be saved *without* a bank crash. That means rolling back the enormous gains that the FIRE sector has made since 1980 at the expense of the "real" economy. Banks have ceased to be an "engine of growth." They are not making loans to create new means of production. They are lending to asset strippers, not asset creators. It is not hard to show this statistically. (I drafted an attempt in *Killing the Host*, and am now working with Democracy Collaborative to prepare a larger study.)

At stake is whether the U.S. and Western European economies are going to end up looking like those of Greece, Latvia and Argentina – or imperial Rome for that matter. Neoliberals applaud today's victorious finance capitalism as the "end of history." One such end has already occurred once, at the close of Roman antiquity. It is remembered as the Dark Age. Progress stopped as the creditor and landowning class lorded it over the rest of society. Trade survived only among the lords at the top of the economic pyramid. Today's "End of History" dream threatens to unfold along similar lines. It is all about relative power of the One Percent.

Notes.

[1] Paul Krugman, "Days of Fear, Years of Obstruction," *The New York Times*, September 14, 2018.

[2] John Cassidy, A World of Woes: A global take on a decade of financial crisis," *The New Yorker*, September 17, 2018.

[3] "Ben Bernanke pins blame for Great Recession on bank panic," *Financial Times*, September 13, 2018.

[4] Ellen Brown recently published a review, Central Banks Have Gone Rogue, Putting Us All at Risk." Public Banking Institute and *Truthdig*, September 13, 2018.

[5] Glenn Hubbard, "Bailouts Shouldn't Be Only for Banks"*Wall Street Journal*, September 14, 2018. To be sure, Hubbard acknowledges that Republicans had agreed to but incoming President Obama nixed: "The government should have directed a mass refinancing of mortgages for primary homes in which the borrower was current in payments."

[6] Adair Turner, "Banks are safer but debt remains a danger," *Financial Times*, September 12, 2018.

[7] Demosthenes *Against Timocrates* (xxiv.149).