The Failure of US Neoliberalism: Financial Panic, Economic Stagnation – and What We Can Do About It

Bill Barclay,

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Three Sections

- What caused the financial panic and economic stagnation?
- What are the current policies proposed by elites? Will they work?
- What should be done?

Remember when teachers, public employees, Planned Parenthood, NPR and PBS crashed the stock market, wiped out half of our 401Ks, took trillions in taxpayer funded bail outs, spilled oil in the Gulf of Mexico, gave themselves billions in bonuses, and paid no taxes? Yeah, me neither... Pass it on

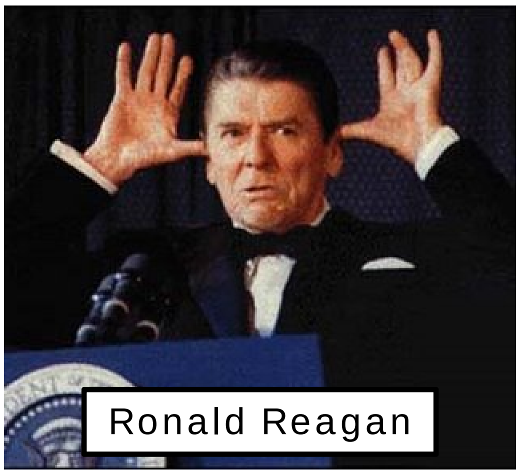
Understanding the Causes: What is Neoliberalism?

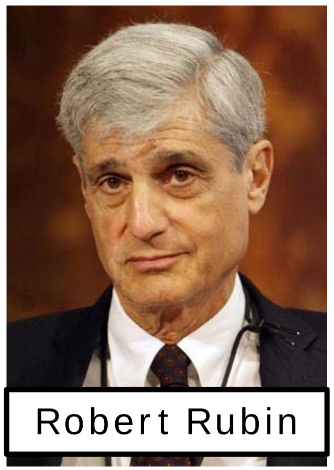
- Markets are the fundamental mechanism through which individuals interact.
- Markets maximize efficiency; government intervention is always second best.
  - Therefore: Expand scope of markets. (This is called "deregulation.")
  - Therefore: Reduce size of government (cut spending for social goods).

more . . .

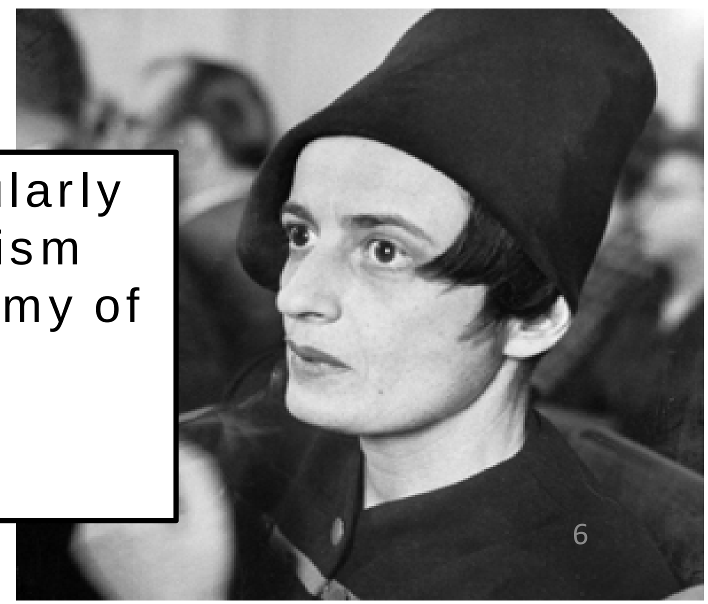
- Markets maximize individual freedom,
  - Therefore: Favor **choices** made by individuals over collective action (individualism).
  - Therefore: Reduce the power of collective voices such as unions.
- Financial markets and financial trading are particularly important because they enable us to better determine the fair value of a good or service.
  - Financial markets are enhanced by new financial products.

These new [financial] technologies lay off all the risk of highly leveraged institutions on stable American and international institutions.
- Alan Greenspan


Ronald Reagan


Robert Rubin

All the evils, abuses, and inequities, popularly ascribed to businessmen and to capitalism were not caused by an unregulated economy of by a free market, but by government intervention into the economy.
--Ayn Rand



What Was Done: Neoliberal Policies Increased Economic Inequality

- The US has the highest level of inequality among wealthy countries.
- This increase of more than $1 trillion/year to US top 1% has not gone into job creation.
- The most important result: since the 1970s, the US has been an asset price bubble driven economy (commodities, dotcoms, and housing).
- The housing price bubble was the biggest and the collapse the most devastating.

What Was Done: Neoliberal Policies Created a Finance-Dominated Political Economy

- Financial sector grabbed over 40% of total business profits.
- Financial sector profit rates (ROE) of over 20%.
- Financial sector assets–and debt–became larger than US GDP.
  – Six largest banks have assets of $1 trillion or more.
- These are remarkable numbers–how did it happen?

Financialization

- Velocity of trading increased.
- What could be traded expanded.
  - Lending (including mortgage lending) creates debt and wealth.
  - Securitization makes this debt/wealth tradeable.
- Amount available to trade grew.
  - Mortgage originations soared.
  - Subprime mortgage market exploded.
  - Financial products/unit of debt increased (e.g., CDS).
- Leverage jumped.

The Collapse of the Housing Bubble: Financial Panic of 2008

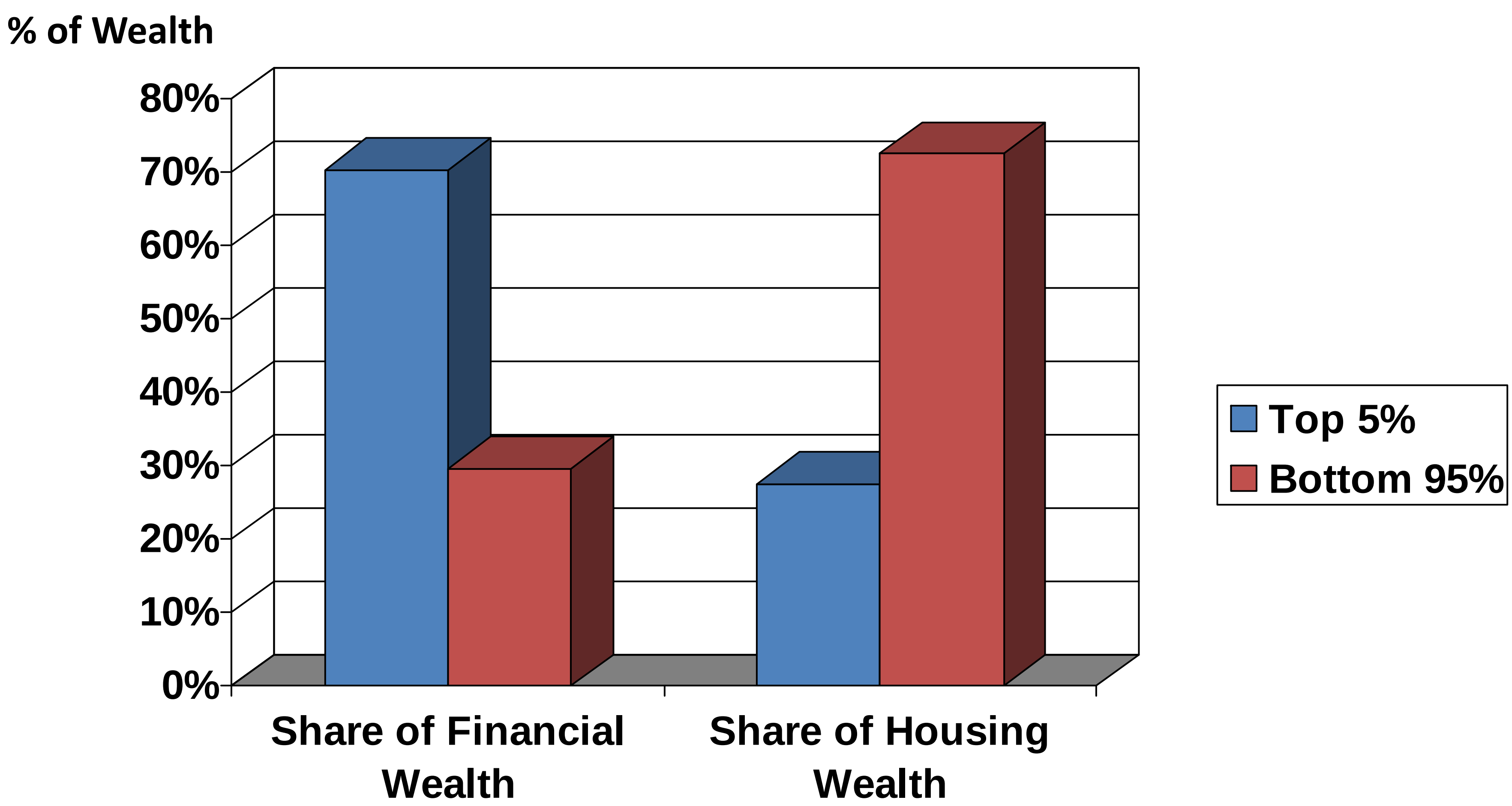
- The 2008 financial market panic
  - Bear Stearns collapsed March 2008.
  - Merrill Lynch on verge of collapse–acquired by Bank of America Sept. 14, 2008.
  - Lehman Brothers went bankrupt Sept. 15, 2008.
  - Fed rescued AIG Sept. 16, 2008.
  - Washington Mutual seized by FDIC Sept. 25, 2008.
  - 2008 was the 3rd biggest stock market drop in US history.
- **If you owned financial wealth (stocks, bonds, business equity), you were really scared.**

The Collapse of the Housing Bubble: The Impact on the Real Economy

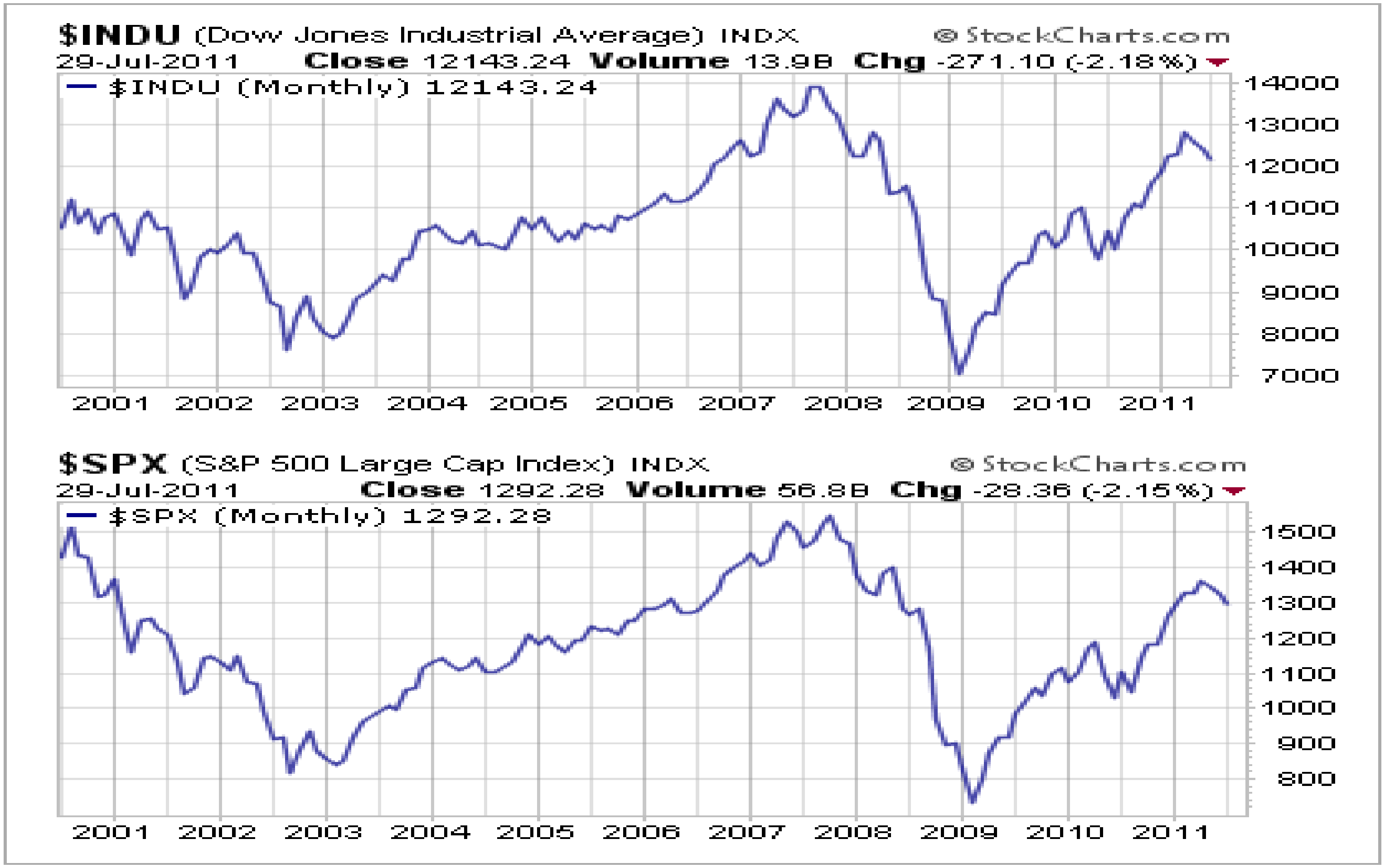
- Housing and housing connected consumption = 25% of total GDP
- When housing prices dropped:
  - Housing starts plummeted
  - 2 million lost construction jobs
  - 8 million total lost jobs
  - Sales of appliances, furnishings, autos etc. dropped, so more people were laid off
  - Foreclosures skyrocketed
  - GDP fell almost 4% in 2008
- If you had a job or owned a house, you were (or at least should have been) scared.

Whose Wealth Would Be Saved?

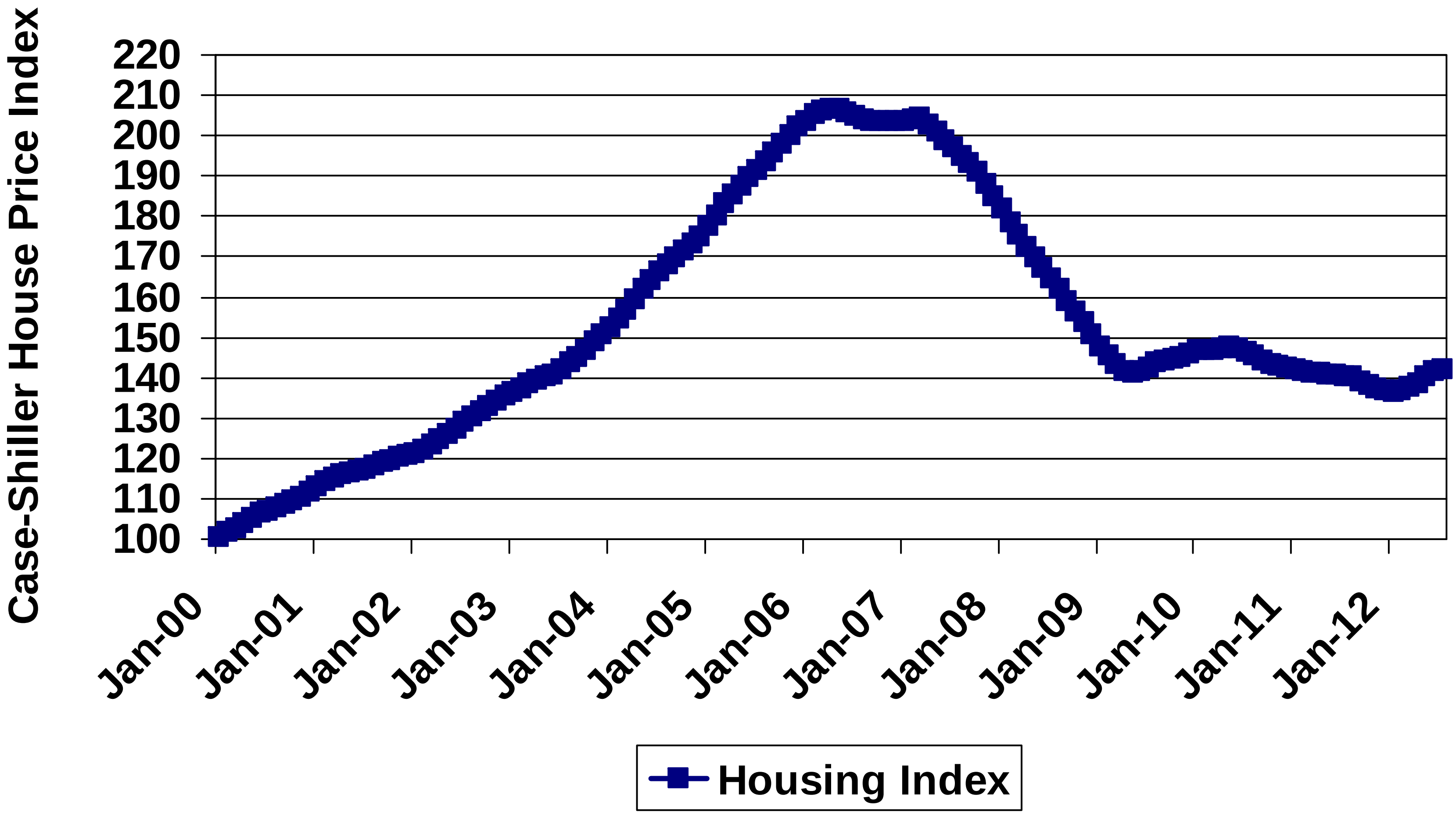
(2007 wealth distribution by type)

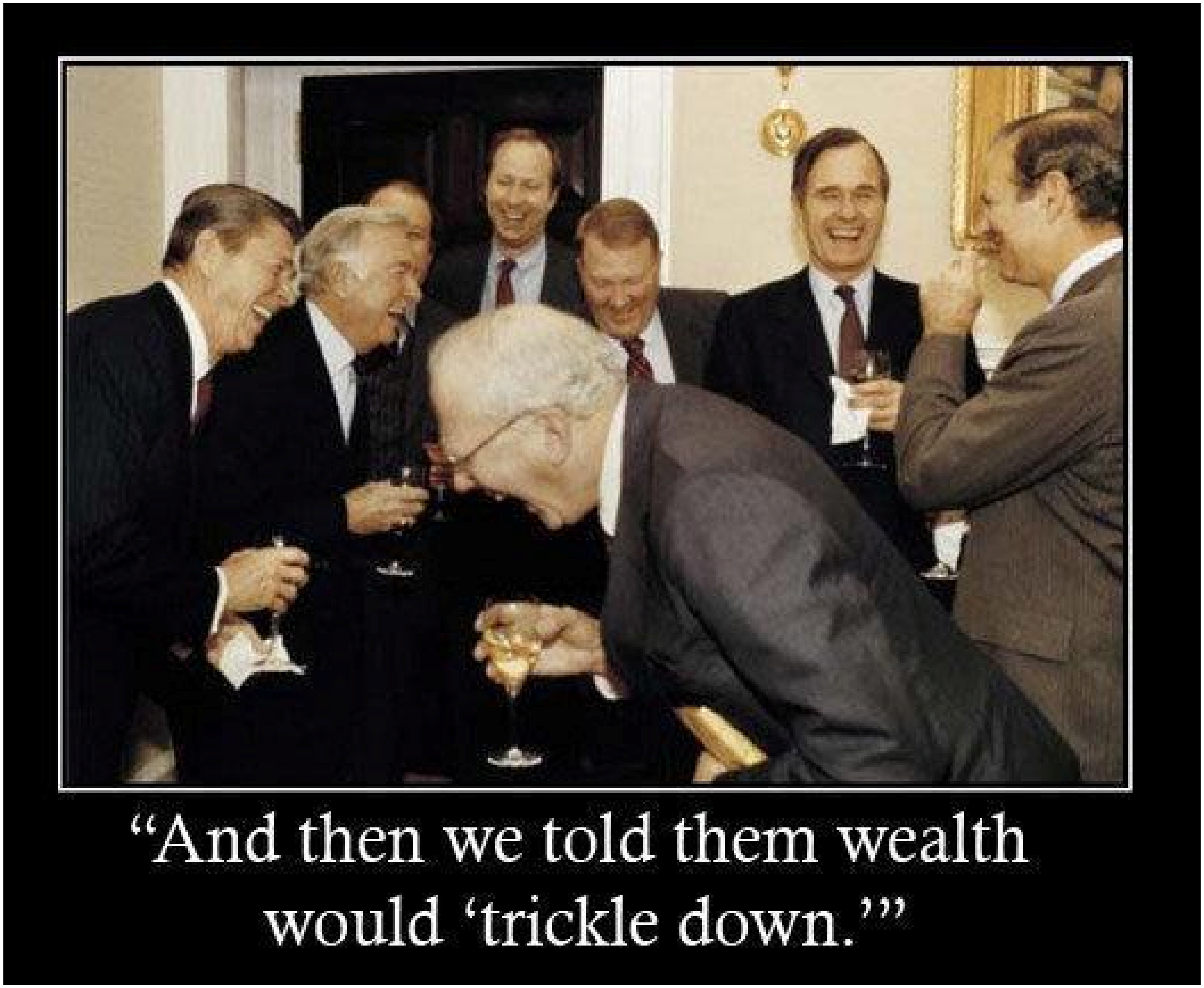


The Stock Market Has Recovered



Housing Wealth Has Not Recovered




"And then we told them wealth
would 'trickle down.'"

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Where We Are Today: A Picture of Economic Stagnation

- The Great Recession officially ended June 2009.
- At the end of 2012 we have:
  – More than 15 million job shortage
  – A $13 trillion loss of housing wealth
- Result: A bigger economic shock to private sector than in 1930s.
- We have gone from financial crisis to economic stagnation.

It's Right Around the Corner—Trust Me

So, What Policies Are Elites Proposing?

- Reduce the debt, reduce deficits–or we'll become Greece and won't be able to pay our debts!
  - A country that controls the creation of its own currency and borrows in that same currency cannot run out of money.
- Cut "entitlements"–we can't afford them!
  - These are actually earned benefits.
  - Note: Social Security cannot contribute to the debt and is therefore irrelevant to the debt discussion.
- Cut taxes for the "job creators" to get the economy going again.
  - Continuing to do the same thing over and over again and expecting a different outcome is the definition of insanity.
- These "proposals" will do nothing to end economic stagnation.
  - They actually threaten the fragile "recovery."


I'M ENTITLED TO MY BUSH TAX CUT...
..ENTITLED TO LOW TAX RATES ON INVESTMENTS...
..ENTITLED TO AN ARMY OF LOBBYISTS..
NW K ST
..ENTITLED TO BUY POLITICIANS...
...AND ENTITLED TO BLAME OUR PROBLEMS ON.....
..ENTITLEMENTS!

Debt, Governments and Households

- Adam Smith's teacher, Mandeville: A market economy runs on private vices/public virtues.
- In a period of economic stagnation, the reverse is actually true: Private virtues are public vices.
  - Consider what happens if all households decide to cut spending and/or save more.
- Morally good, economically bad
- Who can intervene? Government
  - Growth of government debt is the reason our Great Recession has not (yet) become a major depression.
- **Economies and governments are not large versions of households.**

Austerity doesn’t solve the problems.
It exacerbates them.

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  - Housing
  - Jobs
  - Finance

Housing – What Is To Be Done?

- To date: foreclosure relief programs are limited in scope.
- To date: foreclosure programs are limited in size.
- The $25 billion + $10 billion settlements with banks sound like large numbers . . . but
- Fed estimates total underwater amount at **$700 billion.**

We’ve Been Here Before

- 1933 FDR/Congress created the
  Home Owners Loan Corporation (HOLC).
  - HOLC issued federally guaranteed tax-exempt debt.
  - The debt was swapped for mortgages.
  - HOLC independently appraised the houses and issued 30 year, fixed rate mortgages tied to the house value.
  - This kept many people in their homes.
  - HOLC rehabbed foreclosures + rented the houses.

- HOLC ended with a small profit for taxpayers.

Could We Do a HOLC II?

- Who would be eligible:
  - Any mortgage borrower with 10% or more negative equity.
  - Any household with a long term unemployed individual.
  - All mortgages tendered under the program that are not fixed rate mortgages would be converted into the same.
- As in the 1930s, the borrowing costs for a federally guaranteed entity are very low.
- in July 2012, Sen. Jeff Merkley (D-OR), proposed “The 4% Mortgage: Rebuilding American Home Ownership” legislation that embodies much of this HOLC II outline.

This program does not require any finding of fraud by banks.

This program would be largely **self-financing.**

Solving Unemployment: I

- In 2008, CPEG developed a jobs program.
- Goal: a job for anyone willing and able to work.
  - Create 4.5 million new jobs/yr for five years.
  - Most of those jobs would be hires in the public sector.
  - Would pay a living wage ($18/hr).
  - Included training for new labor market entrants.

Solving Unemployment: II

- Three sectors:
  - Traditional physical infrastructure
  - Social infrastructure (sustainable growth)
  - Green manufacturing/energy retrofitting
- Cost? About $135 billion/yr
  - This is cumulative.
- Rep. John Conyers (D-MI) HR 870 embodies much of this program.
- So, how could we pay for this?

Paying for a Jobs Program: Taxing Finance

- There are a large number of reforms that we need in finance.
- A financial transaction tax
  - A small fee (0.10% or 0.05% of value traded)
    - $1 on $400 of stocks traded
    - $1 on $800 of derivatives traded
- Rep. Keith Ellison's (D-MN) HR 6411 (The Inclusive Prosperity Act) does exactly this.
- National Nurses United is pushing it (as are some other unions).
  - Revenue estimate: $350 billion/yr