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The Bailout: a Giant Quick-Fix for Wall Street, But not a Serious Fix for Any Other Part of the Street

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The U.S government’s $700 billion to possibly $1 trillion bailout for Wall Street banks and investment companies did not even buy a sense of temporary confidence in global markets - at least in the short run, judging by the continual wide fluctuations in the U.S., and now, world stock markets. It is quite possible that the bailout will emerge as one of the biggest financial mistakes made by the US.

The idea underlying the bailout is that banks and other financial institutions could be relieved billions of dollars of bad loans and risky financial packages in return for some degree of U.S. treasury control over future decision-making. Since the current fiscal crisis has produced a boa constrictor vise on credit, the hope is that the bailout will encourage a resumption of higher levels of credit availability for businesses. And this will mean more business and economic activity, acting as a correction for the market.

It is presumed that this quick fix could re-direct the economy, but there are already signs that the strategy is doomed to failure. The reason for such is that the root causes of the current financial crisis are not being addressed. Until this takes place, domestic and international institutions will continue to be wary about providing credit.

The financial crisis and bailout has generated a debate between conservatives and more liberal-leaning elected officials in the U.S. The former contend that it was a regulatory framework - not weakened enough - that has led to the current crisis. Some observers in this camp have suggested that troubles started when Fannie Mae and Freddie Mac were “forced” to provide loans to poor people, especially, African-Americans and Latinos. Others point to the Community Reinvestment Act as the culprit. In 1977 this law established rules for the monitoring decision-making regarding the distribution of housing loans on the part of banks in inner city neighborhoods throughout the nation.

Liberals are in general agreement that a de-regulatory framework is the culprit. Beginning with the Reagan presidency, financial institutions were allowed more flexibility and less oversight by government and regulators.

There certainly was a movement to de-regulate business and let the free market do its thing; but it is inaccurate or incomplete to point the finger at Republican administrations. In fact, major movement to de-regulate businesses and its consequences were fast-forwarded under the Clinton administration. Writing for *Dissent* (Summer 2008) magazine, Timothy Canova observes that "Predatory lending was not an invention of the Bush administration. High interest payday loans and subprime mortgages took off under Clinton…teaser loans were structured so that monthly mortgage payments would start off low and rise significantly in the future, even while overall loan amount-the outstanding principal-would also rise. The borrower would end up worse off several years into the mortgage than when the loan began." Canova adds: "…none of this was considered overly problematic by the Clinton White House. There was simply too much money to be made by lenders, brokers, bankers, bond insurers, ratings agencies, engineers of securitized assets, and managers of special investment vehicles and hedge funds. There was also too much to be gained by elected officials and regulators looking the other way." Overlooking how **both** political parties and several administrations were responsible for the current situation will not point honest and non-partisan analysis of the current fiscal situation.

Another story has been missing in these debates and in the overall discourse about the cause of the crisis, and what might be appropriate and strategic responses. Overlooked in the design of the bailout plan is the fact that the financial crisis was in the making when stories about the market exploitation of low-income and working-class communities, mostly communities of color, were starting to appear in the media. This is the point when government should have started to pay attention. In 2003 and 2004 foreclosures in low-income neighborhoods started to explode in numbers and rapidity throughout the country. Foreclosure patterns in many urban communities of color exhibited patterns of "spatial concentrations", where entire blocks and sub-neighborhoods experienced rapid increases in the number of foreclosure petitions.

It was clear to some observers on the ground that certain communities, many with a high proportion of low-income families, were being targeted for predatory lending practices or as places where sub-prime mortgages could be exacted. Community activists like Ana Luna in the city of Lawrence, Massachusetts - one of the poorest cities in the New England region - held many community meetings three and four years ago (!) to try to awaken the general public's knowledge of how low-income communities were being utilized via housing to subsidize growing and vast profits for financial institutions. Along with other activists, she encouraged the Lawrence City Council to adopt a "foreclosure watch zone" for one of the poorest neighborhoods in this city, but where homeownership via sub-prime loans was taking place at a rapid and explosive rate. The immediate purpose of this city council resolution was simply to tell the rest of the state that we have a big problem on our hands.

These spatial concentrations of foreclosures in places like Lawrence, Holyoke, Springfield, Worcester, neighborhoods in Boston, and other places resulted not only in the loss of homes, but consequently, other kinds of losses. As families lost their homes in low-income communities, there was a precipitous drop in consumer expenditures; this, in turn, had negative impacts on small and local businesses; which in turn meant a loss of jobs at the local level; and ultimately it also meant a decline in property taxes paid. Unfortunately, these episodes - occurring all over the country - were ignored not just by Wall Street, but the homeowners on Main Street. Perhaps the massive profits being made off the backs of hard working people in communities of color were too enormous to get the general public to worry about the plight of low-income neighborhoods.

If government, the private sector, and the general public had earlier treated the rising foreclosures in communities of color as a serious matter, would we be in this same situation today? And what would be the situation today, even for Main Street, if the general public had expressed more concern about the economic suffering at the poor end of town? In a 1928 essay, *The Intelligent Woman's Guide to Socialism and Capitalism*, the philosopher George Bernard Shaw eloquently pointed out that the rich end of town will live or die by what happens on the poor end of town. This fact holds true for all those families and homes living in the middle of town. Eventually, and very rapidly, as thousands and thousands of low-income households in some neighborhoods felt the impact and sense of economic insecurity associated with massive numbers of foreclosures, and very much geographically concentrated in these places, the economic effects began to spread to Main Street.

Until the connection between those not yet living on Main Street, with those living on Main Street, and Wall Street is appreciated, any bailout strategy will have a limited impact on the current and still unfolding financial crisis. An effective bailout strategy will have to respond to the damage done to families and neighborhoods on the lower end of the socio-economic ladder. This first step of the ladder has to be fixed before we can get to Main Street or Wall Street.

The recent bailout initiative passed by the U.S. Congress will not address this issue. Not one of the key features of bailout plan addresses this situation. Raising the Federal Deposit Insurance Corporation's insurance limit from $100,000 to $250,000 is nice, but in terms of low-income, working-class, and middle-class households, who is worried about protecting their $250,000 held in a savings account? The new deductions on local property taxes will benefit a few taxpayers - but have legislators been reading the horror stories? A deduction for local property taxes probably seems surreal to homeowners facing the loss of their homes.

The actions of sub-prime lenders a few years ago have yet to be played out. In Massachusetts, for example, something like 40,000 to 45,000 mortgages are scheduled to be reset at higher interest rates in the year 2009 and 2010. The suffering will continue, and it is not unique to Massachusetts. As these resets lead to more foreclosures across US cities, there will be continual dampening of consumer expenditures and increasing unemployment. Small business will continue to find fewer customers. And, local and state governments will see significant reductions in the collection of property tax revenue and thereby will be unable to meet a $40 billion shortfall noted in a recent article in the *Wall Street Journal* (July 24, 2008).

In this context, why should banks or financial institutions ease credit in any significant way? Alas, Wall Street, via the reaction of stock markets to the recently enacted bailout, is reflecting some wisdom! It understands that this quick fix, mostly benefiting giant financial corporations, does not address a fixing of the basic problem - economic health for those at the bottom of the socio-economic ladder; it does not address, furthermore, the trillion dollar market that might go bad as a result of the gambling that took place via "credit default swaps", a mechanism that allowed investors to collect high returns by betting that certain kinds of investments would gain or lose value. It is clear that the wisest and safest strategy for banking and investment institutions regarding credit, today, is to continue being as conservative as possible.

U.S. taxpayers are being asked to buy back corporate irresponsibility in the hopes that credit will be eased. This is not a formula for success. The latter will only occur when government decides to respond directly to the consequences of the exploitation of millions of low-income households in neighborhoods across the nation. The reaction of world stock markets to the current bailout plan indicates that addressing the context and root problems is probably a better strategy than a quick fix to simply buy back bad debts. In fact, $700 billion could be used to pursue strategies that will allow families to keep their homes as a fundamental and first step. Government could use some of this money to work with industry to ensure that there are jobs for people to work, earn wages, and spend money.

The current bailout overlooks that what happens at the poor end of the street, or the poor end of town, must get the same attention that Main Street should receive, and same attention that Wall Street has enjoyed. The foundation of a strong national economy is not solely about Main Street's economic health, and certainly not simply a bailout for irresponsible behavior on the part of some big wheelers on Wall Street. The economic health of Main Street is linked to Wall Street, but both are linked to the economic health of those who have yet to realize the resources to live decently on Main Street, and were exploited by private institutions, and indirectly by government and those living on Main Street, who winked and benefited for a while, at the exploitation.

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