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The End of Neo-Liberalism and Bush's Last Scam: How Racism Sparked the Financial Crisis

By Joe Sims
Black**C**ommentator.com **Guest Commentator**

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With the collapse of several banks and insurance companies, the near bankruptcy of Detroit automakers, a 50 percent drop in world stock exchanges and an almost complete arrest of credit markets, an economic era has ended. It seems almost an understatement to say that capitalism has entered a new stage of a protracted systemic crisis.

The crisis of the economy is at once, a crisis in ideology. After 30 years of worship at the shrine of the free market, Reaganomics and other branches of conservative and neo-conservative thought seem bankrupt and thoroughly discredited, if not dead - and not only right-wing schools. Deregulation, privatization, intense financial speculation on debt, the scaling back if not elimination of government social spending, in a word, "neo-liberalism" has reached its extreme limit almost bursting state-monopoly capitalism's seams and triggering a worldwide financial meltdown.

Many causes have been attributed to the turmoil. Among the main contenders: "financialization" or the capitalism-on-crack of the bond markets and banks, a crisis of overproduction (too many goods chasing too few dollars), and a weak "real" economy due to insufficient allocation of surplus capital to productive investment. Some point to objective processes, others stress mistaken policy decisions. Clearly all were, to one degree or another,r at play. Caution is in order, however. Objective economic processes, mistaken fiscal policies or even chance economic accidents, taken together or alone do not sufficiently explain the impetus behind the ongoing calamity. Also at work was institutionalized racism in the form of unfair lending policies that systematically targeted Black and Latino homeowners, a targeting that may prove as deadly to the financial system as the arrow that pierced Achilles heel.

Slouching Toward Collapse

The origins of how the unraveling began is to be found in capitalism's attempt to resolve ongoing crises. In fact, the neo-liberal model itself arose in response to attempts in advanced capitalist countries to maintain profits and find new markets. Faced in the 1970s with a declining rate of profit, a fractured world economy divided into "socialist" and capitalist camps, structural and fiscal crises along with spiraling inflation, capitalism's generals undertook a re-forging of economic policy in the form of a wholesale assault on the edifice of the New Deal. Keynesianism had run into a wall - at least from the point of view of big capital - and policy was now modulated to fit the maximum profit categorical imperatives of the new period. International trade pacts were formed, unions were rolled backed or held in check and fiscal policy was loosened, as a new "post-industrial" service-oriented economy emerged.

At the center of this process was a huge transfer of wealth to the super rich, accomplished by means of tax cuts and a huge leap in labor productivity, as the corporate class acquired an even greater share of the surplus. For a period, neo-liberal economic policy seemed to work, lending the appearance of stability with low unemployment, relative labor peace and mild inflation, causing some to wonder if capitalism had become crisis free.

Finance capital began to play an increasingly dominant role. Stressing this aspect Sam Webb writes:

> "…what is different in this period of financialization is that the production of debt and accompanying speculative excesses and bubbles were not simply passing moments at the end of a cyclical upswing, but essential to ginning up and sustaining investment and especially consumer demand in every phase of the cycle."

When, at times confronted with cyclical episodes of economic instability amid the bursting of speculative bubbles, monetarist solutions were seen as a panacea. Strengthening money supply from monopoly capital's point of view may have helped but in contradictory ways as wages, particularly after the recession of 2001, remained stagnant or declined. At key moments in the cycle, crisis emerged. With worker compensation nearly frozen, where was the purchasing power necessary to keep the circulation process moving? Resolving this problem was a chief preoccupation of bankers, CEOs and bureaucratic policy-makers alike.

Indeed, a study of productivity and wages over the last quarter century reveals the acuteness of the problem. From the mid-1970s on, driven by speed-up and new technology, productivity increased dramatically, particularly after 2000. Pay however, remained stagnant. Tracing patterns of pay and productivity, an economist writing for the *The Daily Kos* noted:

> "If the lines [productivity and wages] had continued to track closely together as they did prior to the 1970s, the minimum wage would be more than $19 an hour. The minimum wage!!! (emphasis in the original). So, in short: people had no money coming in in their paychecks so they were forced to pay for their lives through credit - either plastic or drawing down equity from their homes."

John Bellamy Foster and Harry Magdoff in an important article in *Monthly Review*, titled, "Financial Implosion and Stagnation", also mention the equation of productivity and wages:

> "This reflected the fact that real wages of private nonagricultural workers in the United States (in 1982 dollars) peaked in 1972 at $8.99 per hour, and by 2006 had fallen to $8.24 (equivalent to the real hourly wage rate in 1967), despite the enormous growth in productivity and profits over the past few decades."

Debt accumulation was key. Speculative bubbles (in information technology and housing) became a driving force in overcoming each new crisis point. Low long-term interest rates had allowed large numbers of people to purchase homes. With rising home prices, experiencing growing debt - and lured by an intensive marketing campaign in the '90s by Citicorp and others - families took out second mortgages en masse.

"Until the early '90s," comments Robert Brenner at the November 2008 Berlin symposium organized by the Rosa Luxemburg Foundation, "Bubblenomics allowed people to get wealthy they thought on paper. One hundred percent of wealth is driven by borrowing and consumption, borrowing and residential investments."

Desperately Seeking Higher Profits

Capitalism hit another wall, however. During the boom, purchase costs rose quickly, pricing new buyers out of the market. Standard mortgages plummeted. In addition, low long-term interest rates meant low profit returns for investors. A new crisis emerged. In these circumstances, confronted with the need to maintain profit rates and find new markets in conditions of declining wages, bankers deliberately devised loan strategies with hidden fees and ballooning interest rates that would greatly elevate the rate of return, targeting unsuspecting and ill-informed consumers. Under the ideological guise of George W. Bush's "Ownership Society" credit would be extended to potential homeowners with low incomes and allegedly marginal or bad credit - the sub prime crisis was born.

The proliferation of sub prime loans can be traced to the aftermath of the dot-com bubble. After the bubble burst, speculators turned to the housing market. As Yale economist, Robert Shiller, asked in 2005, "Once stocks fell, real estate became the primary outlet for the speculative frenzy that the stock market had unleashed. Where else could plungers apply their newly acquired trading talents?"

As it turned out, the supply-sider's solution to the precipitous decline in technology stocks achieved a momentary short-term fix, but carried within it seeds of a more profound and destructive crisis. The editors of the German magazine, *Der Spiegel*, in a recent article spelling the displacement of US capital, argued that, "once again, Greenspan flooded the economy with money and, yet again, Wall Street started looking for a new market for its growth machine. This time it discovered the American homeowner, convincing him to take out mortgages at favorable terms, even when there was practically no collateral."

Capital then flooded the housing market as real estate became a national corporate mania. "These days, the only thing that comes close to real estate as a national obsession is poker," commented Shiller.

Brenner suggested that this mania peaked in 2003: "Mortgage origination (house purchases) peaks in 2003 … but the economy expanded through 2007, after which there is a decline." He continued, "Normal mortgages, called conforming mortgages in which people have to have a certain income and put up certain collateral or down

payment … plummeted in 2003 and 2004."

"What saved the day? Just when the conforming mortgages were falling non-conforming mortgages, sub prime or 'alt A' or 'liars loans' take over in driving the bubble."

The Federal Reserve, as suggested by *Der Spiegel*, was directly responsible. Brenner confirmed this thesis; "Sub prime mortgages," he said, "became so possible, because Greenspan came in again and reduced short term interest rates to one percent in 2003, the lowest of the postwar period in the face of this problem, which meant that for two years real short term interest rates were below 0. And he did that because sub prime mortgages are governed by variable interest rates."

In article at *Portfolio.com* titled, "The End of Wall Street's Boom," writer Michael Lewis also emphasized the role of the new niche market: "More generally, the sub prime market tapped a tranche of the American public that did not typically have anything to do with Wall Street. Lenders were making loans to people who, based on their credit ratings, were less creditworthy than 71 percent of the population."

The growth of this niche market was spectacular. In 2000 there was between $60 and $130 billion invested in sub prime mortgages. By 2005 the amount had grown to $605 billion. This increase was largely attributable to Wall Street banks, conniving with lower level mortgage companies to devise schemes to make huge sums of money by placing side bets on bad loans likely to default. They did so knowingly, creating "exotic financial instruments" and then short selling the market.

Lewis described with precision the means by which the process was begun - short selling the market - and uncovers just how deep finance capital's complicity ran. "The big Wall Street firms," Lewis argued, "had just made it possible to short even the tiniest and most obscure sub prime-mortgage-backed bond by creating, in effect, a market of side bets."

Lewis, himself the author of a best-selling whistle-blowing 1980s expose of Wall Street, *Liar's Poker: Rising Through the Wreckage on Wall Street*, interviewed some of the key players in the sub prime swindle, including a hedge fund's primary trader, one Steve Eisman, who realized what the big investment houses were doing and profited handsomely from it. Lewis described Eisman as "perplexed in particular about why Wall Street firms would be coming to him and asking him to sell short."

The answer: profits. So profit hungry were the Wall Street traders that they pushed these new mechanisms to their farthest limit, creatively manipulating what Marx called fictitious capital. Lewis noted:

> "In fact, there was no mortgage at all. 'They weren't satisfied getting lots of unqualified borrowers to borrow money to buy a house they couldn't afford,' Eisman says. They were creating them out of whole cloth. One hundred times over! That's why the losses are so much greater than the loans. But that's when I realized they needed us to keep the machine running. I was like, this is allowed?"

Not only did banks and investment firms create this phony capital, there was ruling class complicity all down the line, a complicity that included, in addition to the Republican standard bearers, Democratic centrists like former Treasury Secretary Robert Rubin, then an executive of the recently bailed out Citicorp.

The beginning of the end came in 2006, according to the editors of *Monthly Review*: "The housing bubble began to deflate in early 2006 at the same time that the Fed was raising interest rates in an attempt to contain inflation. The result was a collapse of the housing sector and mortgage-backed securities."

Frantic efforts to throw more money at the problem, so often criticized by the Republican right when applied to social programs, proved of no avail. Foster and Magdoff write that the new chief US financial officer, ever the student of Greenspan and Friedman opened Fort Knox:

> "Confronted with a major financial crisis beginning in 2007, Bernanke as Fed chairman put the printing press into full operation, flooding the nation and the world with dollars, and soon found to his dismay that he had been 'pushing on a string.' No amount of liquidity infusions was able to overcome the insolvency in which financial institutions were mired."

Looking back, even conservative *New York Times* columnist, Thomas Friedman, claimed disgust in a recent op-ed titled "All Fall Down." Doling out blame. Friedman believes responsibility begins with

> "People who had no business buying a home, with nothing down and nothing to pay for two years; people who had no business pushing such mortgages, but made fortunes doing so; people who had no business bundling those loans into securities and selling them to third parties, as if they were AAA bonds, but made fortunes doing so; people who had no business rating those loans as AAA, but made fortunes doing so; and people who had no business buying those bonds and putting them on their balance sheets so they could earn a little better yield, but made fortunes doing so."

Imagine the audacity of comparing working-class families to Wall Street titans! Everyone else was getting paid: the mortgage brokers whose fees increased the bigger the sale with no penalty to themselves; the banks who then bundled the loans up and sold them to other financial institutions around the world again, seemingly with no losses; the rating agencies who allowed it to happen. Only working families were left holding the bag.

Friedman, quoting Lewis, revealed Wall Street's unabashed cynicism: "Eisman knew that sub prime lenders could be disreputable. What he underestimated was the total unabashed complicity of the upper class of American capitalism... 'We always asked the same question,' says Eisman. 'Where are the rating agencies in all of this? And I'd always get the same reaction. It was a smirk.'"

Eisman himself is unsparing in his criticism: "That Wall Street has gone down because of this is justice," he says. "They fucked people. They built a castle to rip people off. Not once in all these years have I come across a person inside a big Wall Street firm who was having a crisis of conscience."

Race and the Housing Bubble

As it turned out, a disproportionate number of the people they "fucked" were African American and Latino families. Perhaps this explains at least in part why no Wall Street insiders had qualms about their activities or why in recent weeks the issue seems to have almost disappeared from discourse on the economic crisis. Attention to this highly important issue was given in 2008 when the Urban League, the NAACP and the Congressional Black Caucus made it the centerpiece of their annual conferences. As the

fall election campaign swung into high gear, however, save for oblique references by the Republican candidate, John McCain, concerning the "mismanagement" of Fannie Mae and Freddie Mac and more caustic comments by demagogues like Ann Coulter blaming Black and Latino families for the crisis, the electoral discourse at the height of crisis largely stayed away from what may have been conceived as a racially charged issue.

Still, as the main civil rights organizations charged in the summer of 2008, the racial origins of the sub prime crisis are difficult to ignore. A cursory glance at some of the statistical highlights of the crisis provides ample evidence. An excellent study authored by United For a Fair Economy titled, "Foreclosed," suggests several indicators, chief among them the disproportionate numbers of people of color holding sub prime loans: over 50 percent of all mortgages held by African Americans fall into this category. The figure is 40 percent for Latinos.

These percentages have grave economic implications: "Given that people of color are a disproportionate number of the sub prime borrowers, and that this group's assets are mostly concentrated in homeownership, the current foreclosure crisis can be considered the greatest loss of wealth for communities and individuals of color in modern US history." Black and Latinos will lose between $164 and $213 billion for loans taken during the past eight years.

The disproportionate numbers of Blacks and Latinos with sub prime loans, while suggestive, serves as only partial explanation. The central question is what caused it? Were the higher relative percentages merely the casual result of ongoing poverty or was a more causal underlying factor at play? Bush administration policy provides important clues.

Sub prime loans were allegedly established and encouraged as part of government and corporate efforts to provide support for struggling working-class families troubled with bad credit histories. Truth be told, former President Bush himself pushed the program, believing it would create "stakeholders" in an "Ownership Society" and expand meager Blacks and Latino support for the Republican Party. In the view of the *New York Times*, the Bush "pushed hard to expand homeownership, especially among minorities, an initiative that dovetailed with his ambition to expand the Republican tent - and with the business interests of some of his biggest donors."

Indeed, "the business interests of some of his biggest donors" goes to heart of the matter. While the sub prime program was supposedly targeted at those with bad credit, and given that a large percentage of minorities fill this category because of poverty, it would seem disproportionality might be a normal outcome of a well-intentioned program's attempt to redress historic wrongs.

Good intentions, however, was not point. At stake were big business interests. A strong case can be made that banks deliberately connived to target minority buyers in order to push profit margins, knowing full well (from their own risk assessment calculations) that the loans could not be repaid. Not only were the banks betting on the defaults, but, in fact, were pressuring prospective Black and Latino borrowers to take out such loans, leading the unwitting customers like so many sheep to a financial slaughter house.

Brenner nailed it:

> "But who would ever lend to them? Who would lend to them is as follows: we talked about that fall in long term interest rates, this is greater for borrowers,

> but if you are a lender or investor you are in deep trouble because return on investment is really low. And investors are in deep crisis and here is where sub-prime loans bailed them out. Sub prime mortgages because they are so risky pay high interest rates and became the basis for financial assets that allowed investor[s] to appear to get high rates of return."

Homeownership, as it turns out, was not the major objective of the lenders. Despite rhetoric promoting an ownership society, only a fraction of loans were awarded to first-time homebuyers. And pubic officials were well aware of this even before the crisis became full blown. In the summer of 2007, in a speech before the Brookings Institute as the credit markets began to seize up, Sen. Charles Schumer (D-N.Y.) charged that:

> "According to the chief national bank examiner for the Office of Comptroller of the Currency, only 11 percent of sub prime loans went to first-time buyers last year. The vast majorities were refinancing that caused borrowers to owe more on their homes under the guise that they were saving money. Too many of these borrowers were talked into refinancing their homes to gain additional cash for things like medical bills."

Lewis, quoting Eisman in the *Portfolio.com* article, revealed what went on in a case very close to home:

"Next, the baby nurse he'd hired back in 1997 to take care of his newborn twin daughters phoned him. "She was this lovely woman from Jamaica," he says. "One day she calls me and says she and her sister own five townhouses in Queens. I said, 'How did that happen?'" It happened because after they bought the first one and its value rose, the lenders came and suggested they refinance and take out $250,000, which they used to buy another one. Then the price of that one rose too, and they repeated the experiment. "By the time they were done," Eisman says, "they owned five of them, the market was falling, and they couldn't make any of the payments."

Nor was bad credit the primary factor for distributing the loans, a myth conveniently circulated and repeated to this day. Schumer again rebutted the notion, quoting none other than the *Wall Street Journal*:

> "Based on the *Journal's* analysis of borrowers' credit scores, 55 percent of sub prime borrowers had credit scores worthy of a prime, conventional mortgage in 2005. By the end of last year, that percentage rose to over 61 percent according to their study. While some will have damaged their credit in the interim, it's clear that many sub prime borrowers have the financial foundation for sustainable homeownership, but may have been tricked into unaffordable loans by unscrupulous brokers."

Thus, working-class Black and Latino families, over half if not 60 percent of whom were eligible for conventional loans, burdened by several years of stagnant and falling wages during a jobless recovery were led by mortgage companies in clear and blatant cases of predatory racially inspired lending.

The racial overtones are evident in this swindle. But what made the loans predatory? The *United For a Fair Economy* study provides the following criteria: One factor is their marketing and sales to inappropriate customers. Another is pre-payment penalties. Seventy percent of sub prime loans had such penalties. A third element was Adjustable Rate Mortgages (ARMS), which often carried unexplained ballooning interest rates that increase payments by as much as one-third. A majority of sub primes were ARMS. Yet another condition was the exclusion of tax and insurance costs when estimating the

monthly payment for a potential home-buyer. And finally the encouragement of ordinary borrowers to take interest-only loans, where in the initial year or two only the interest is paid on, after which the principal rates kick in, raising the cost dramatically.

The Bush administration was not only complicit in these practices, but may have helped mastermind them. "The president also leaned on mortgage brokers and lenders to devise their own innovations," according to the *New York Times*. "And corporate America, eyeing a lucrative market, delivered in ways Mr. Bush might not have expected, with a proliferation of too-good-to-be-true teaser rates and interest-only loans that were sold to investors in a loosely regulated environment."

Might not have expected? In actual fact, the Bush team aggressively tore up regulations, intimidated and fired reluctant administrators, litigated against states bucking their authority, taking cases even to the Supreme Court.

The *Times* continues:

> "As for Mr. Bush's banking regulators, they once brandished a chain saw over a 9,000-page pile of regulations as they promised to ease burdens on the industry. When states tried to use consumer protection laws to crack down on predatory lending, the comptroller of the currency blocked the effort, asserting that states had no authority over national banks. The administration won that fight in the Supreme Court."

When they held a majority, Congressional Republicans, too, were deeply involved in the act on behalf of finance capital, threatening and winning a fight to clarify loan terms. In this regard, the *Times* reported, "The president did push rules aimed at forcing lenders to more clearly explain loan terms. But the White House shelved them in 2004, after industry-friendly members of Congress threatened to block confirmation of his new housing secretary."

Why the bullying, arm bending and other no-holds barred tactics? The answer lies in the necessity of staying competitive and the imperative to achieve maximum corporate profits to do so - on a global scale. *Der Spiegel* quoted a German banker: "'We need a 25-percent return,' or else his bank would not be 'competitive internationally,' Deutsche Bank CEO Josef Ackermann said, thereby establishing a benchmark that would soon apply not just to banks but also to automobile makers, machine builders and steel companies."

Knowns and Unknowns

As is now well known, this drive to stay competitive contributed mightily to the undoing of many of the economies in the developed capitalist countries. Reduced consumption in the US, Japan and Western Europe, is resulting in slowdowns throughout the globe. In addition, as is also widely known, the racist toxic loans born in the US were also exported abroad, precipitating banks runs and other shockwaves to the world financial system and crippling pension funds and even local governments in several countries.

Where it will end remains unknown. Most bourgeois economists are of the opinion that the economic crisis will grow worse before it gets better. Economist Nouriel Roubini, an early predictor of the financial chaos, argues a short term melt down has been averted but is pessimistic about prospects for an early recovery, predicting instead a long-term bottoming out of the economy. He writes:

> "But the worst is still ahead of us. In the next few months, the

> macroeconomic news and earnings/profits reports from around the world will be much worse than expected, putting further downward pressure on prices of risky assets, because equity analysts are still deluding themselves that the economic contraction will be mild and short."

Marxists thinkers, Magdoff and Foster, put things differently: "The prognosis then is that the economy, even after the immediate devaluation crisis is stabilized, will at best be characterized for some time by minimal growth, and by high unemployment, underemployment, and excess capacity."

Roubini contends that the current crisis was not caused by the sub prime scandal but triggered by it, pointing to bubbles in other areas as well, including commercial mortgages, credit cards and students loans. In addition he contends: "these pathologies were not confined to the US. There were housing bubbles in many other countries, fueled by excessive cheap lending that did not reflect underlying risks. There was also a commodity bubble and a private equity and hedge funds bubble."

Magdoff and Foster on the other hand, point to long-term tendencies in the economy toward stagnation and pose financialization, debt, and consumer spending financed by it as a consequence of the underlying weakness of growth. They write: "Since financialization can be viewed as the response of capital to the stagnation tendency in the real economy, a crisis of financialization inevitably means a resurfacing of the underlying stagnation endemic to the advanced capitalist economy."

Whether sub primes caused the great financial instability or simply triggered the deepening of an already existing problem, one thing is sure: its racist origins are undeniable. What Marxist theoreticians like Henry Winston and William L. Patterson called the "Achilles heel" of US capitalism - racism - has once again made itself felt and is sending shockwaves around the world, helping close one chapter in the class and democratic struggle and opening up another.

Magdoff and Foster also employ the Achilles heel metaphor, albeit with a slightly different emphasis:

> "This growth of consumption, based in the expansion of household debt, was to prove to be the Achilles heel of the economy. The housing bubble was based on a sharp increase in household mortgage-based debt, while real wages had been essentially frozen for decades. The resulting defaults among marginal new owners led to a fall in house prices. This led to an ever increasing number of owners owing more on their houses than they were worth, creating more defaults and a further fall in house prices. Banks seeking to bolster their balance sheets began to hold back on new extensions of credit card debt. Consumption fell, jobs were lost, capital spending was put off, and a downward spiral of unknown duration began."

As the struggle around the recovery package begins, it must be pointed out what are termed "marginal new owners" were largely Black and Latino working-class families trying to make ends meet, targeted by Wall Street financiers. Recovery cannot be achieved without an economic package that bails out these homeowners, beginning with a moratorium on foreclosures.

At the heart of the crisis lies the unparalleled greed of the banks, coupled with the declining wages of poor working people, exacerbated by a racist social division of labor. The solution to problem may well continue to lie in the repayment in full of a centuries-old debt. To paraphrase Martin Luther King, capitalism's promissory note is

still marked, “Insufficient Funds.”

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