

Robert Reich
MONDAY, OCTOBER 06, 2008
The Meltdown (Part I)

Global capital markets have seized up. Confidence is evaporating. Put simply, no lender trusts any borrower to repay, fearing that that borrower won't be able to rely on anyone else to honor obligations. Even banks are hoarding cash, unwilling to lend to other banks. Everyone with any savings is heading for the hills -- for gold, for under the mattress, for wherever savings can be watched. We're witnessing a huge international bank run. We have not seen a global financial crisis on this scale since the 1930s.

What's happened? Put simply, the Bailout of All Bailouts has been a dud, at least so far. Most obviously, it hasn't done what it was intended to do -- reassure financial markets that the Treasury and the Fed would have enough money to handle any financial crisis.

So it's everyone and every institution -- and every country -- for itself. Several nations (Ireland, Greece, Germany) have basically guaranteed all deposits. As a result, global capital is moving their way. They're also thereby creating a new form of socialized capitalism. At the rate they're going, these nations will soon own and run their financial markets, and maybe a big chunk of the world's.

I fault Hank Paulson, first and foremost. He never succeeded in explaining to anyone what exactly he'll do with the bailout money -- how, for example, an auction to acquire mortgage-backed bad debt would work, and whether and to what extent he's planning to recapitalize the banking system. Even now, the American public has no idea what he's up to. Nor, for that matter, do many insiders.

Leadership isn't just about passing a big piece of legislation. It's about explaining and thereby gaining trust and confidence from a public -- including a global public -- that's otherwise afraid and confused. A credible and powerful explanation is necessary right now -- about where we've been, how we got into this mess, and how a particular plan (in this case, the bailout), will get us out of it. Yet Paulson has proven himself uniquely unable to explain anything to anyone. George W. Bush, for his part, is hopeless and hapless. Worse than a lame duck, he's a seriously disabled parakeet, with no remaining store of public trust. Ben Bernanke seems like an able fellow but his capacity to communicate is almost as bad as his predecessor's. Congressional leaders are too busy pointing fingers of blame to be capable of explaining much of anything and summoning confidence. And fewer than three weeks before a national election, both candidates are inevitably caught up in partisan wrangling. Obama does understand what's happening, and could calm global capital markets if he were already president. But he is not president as yet, nor even president-elect.

The leadership vacuum could not happen at a worse time. If credit markets remain frozen, we'll soon witness a huge round of business bankruptcies. We're in completely uncharted terrain.

WEDNESDAY, OCTOBER 08, 2008
The Meltdown (Part II)

The easy answer to why the bailout hasn't worked is it hasn't been implemented yet. But its purpose was largely psychological -- to boost confidence that the government is doing something big to clear out bad debts that have been clogging the system. That psychological boost should have happened as soon as the bailout was enacted.

Yet no one seems to believe that 700 billion dollars will make much difference. And today's interest-rate cut, coordinated with the European Central Bank and Bank of England, may not, either. This isn't a liquidity crisis. It's a crisis of trust. Lenders don't trust that borrowers will be able to repay, because they don't think borrowers will be able to collect on what's owed to them. Every major player is moving to safer ground -- holding money, hoarding it, putting it under a giant global mattress.

Bad mortgage loans from the era of anything-goes credit standards started it. But now that America is tipping into deeper recession and unemployment is mounting, more bad loans are cropping up because more people can't pay their bills. And as consumers pull in their belts, more businesses can't pay their bills. Which means more layoffs, and more bad loans, and a global sell-off.

The Fed and other central banks can pour endless money into the system but the problem is no longer just on the supply side. It's now also on the demand side. Which means the federal government, as spender of last resort, has to jump start the economy, as do other governments. Now's the time to start rebuilding our crumbling infrastructure -- roads, bridges, levees, public transit. And help cash-starved state and local governments invest in their schools.

It does make sense to help homeowners directly, as Barack Obama has said. But John McCain last night came up with the stupidist plan I've heard yet for doing so. He wants the government to buy mortgages from the banks at face value and then write down the principal for homeowners. This would be the biggest handout yet to the financial industry. Taxpayers would take all the losses, including the downside risks of additional defaults if houses drop further in value, while the banks would get off scott free.

THURSDAY, OCTOBER 09, 2008
The Meltdown (Part III)

What does it mean that the Dow closed below 10,000 today -- returning to levels first seen nearly a decade ago, in early 1999? Many interpret it to mean that the stock market is finally reacting to the credit crisis. A more accurate assessment is that it's finally catching up to the consumer crisis.

After the market closed today, Bank of America announced a significant deterioration in people's ability to repay credit-card and other consumer debt.

The central fact is this: consumers in the real economy are coming to the end of their capacities to keep spending. They can't take on any more debt. And with the costs of energy, food, and health insurance all soaring, they're doing the only thing they can. They're pulling in their belts. They're leaving the malls. They're not buying a new car or TV or anything else they can do without.

For years, regardless of the business cycle, American consumers were the Energizer Bunnies of the world economy. Their spending kept it going. But now the Energizer Bunnies have turned into scared rabbits, and they're going back into their holes.

Yes, we need better regulation of Wall Street in order to avoid the sort of bubbles and distrust that have generated a credit crisis. But even more than that, we need to get money back into the pockets of average American consumers -- including major investments in infrastructure, affordable health care, and a more progressive tax code.

MONDAY, OCTOBER 20, 2008

The Meltdown (Part IV)

The Dow is see-sawing but the reality is that the Bailout of All Bailouts isn't working. Credit markets are largely still frozen. Despite all the money going directly to the big banks, despite all the government guarantees and loans and special tax breaks, despite the shot-gun weddings and bank mergers, despite the willingness of the Treasury and the Fed to do almost whatever the banks have asked, the reality is that credit is not flowing. It's not flowing to distressed homeowners. It's not flowing to small businesses. It's not flowing to would-be homeowners with good credit ratings. Students are having a harder time borrowing for their tuition. Auto loans are drying up.

Why? Because the underlying problem isn't a liquidity problem. As I've noted elsewhere, the problem is that lenders and investors don't trust they'll get their money back because no one trusts that the numbers that purport to value securities are anything but wishful thinking. The trouble, in a nutshell, is that the financial entrepreneurship of recent years -- the derivatives, credit default swaps, collateralized debt instruments, and so on -- has undermined all notion of true value.

Many of these fancy instruments became popular over recent years precisely because they circumvented financial regulations, especially rules on banks' capital adequacy. Big banks created all these off-balance-sheet vehicles because they allowed the big banks to carry less capital.

Paulson is recapitalizing the banks -- giving them money directly rather than relying on reverse auctions -- largely because he's come to understand that the banks have taken on so much debt that the reverse auction system he told Congress he would use (designed to place a market value on these fancy-dance instruments) will leave too many banks insolvent.

But pouring money into these banks, expecting they'll turn around and lend to small businesses and Main Streets, is like pouring water into a dry sponge. Nothing will come out of it because Wall Street is so deep in debt that the banks are using the extra money to improve their balance sheets. They're hoarding it because their true balance sheets -- considering the off-balance sheet vehicles they created over the past several years -- are in such rotten shape.

In other words, taxpayers are financing a massive effort to save Wall Street's balance sheets from Wall Street's previous off-balance-sheet excesses. It won't work. It can't work. The entire effort is merely saving the asses of lots of executives and traders who got us into this mess in the first place, and whose asses should not be saved at taxpayer risk and expense.

What to do? Immediately require the Treasury to stop the broad Wall Street recapitalization, and require Wall Street to lend the money directly to Main Street. At the same time, force Wall Street to write down its true balance sheets: Let the executives and traders take the hit. Let their shareholders and even their creditors take the hit for Wall Street's colossal irresponsibility. This is the only true way to restore trust. It's also the only way to save Main Street's small businesses, homeowners, students, and everyone else.

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