Has Deregulation Sired Fascism?

By Paul Craig Roberts

24/09/08 "ICH" -- - -- Remember the good old days when the economic threat was mere recession? The Federal Reserve would encourage the economy with low interest rates until the economy overheated. Prices would rise, and unions would strike for higher benefits. Then the Fed would put on the brakes by raising interest rates. Money supply growth would fall. Inventories would grow, and layoffs would result. When the economy cooled down, the cycle would start over.

The nice thing about 20th century recessions was that the jobs returned when the Federal Reserve lowered interest rates and consumer demand increased. In the 21st century, the jobs that have been moved offshore do not come back. More than three million U.S. manufacturing jobs have been lost while Bush was in the White House. Those jobs represent consumer income and career opportunities that America will never see again.

In the 21st century the US economy has produced net new jobs only in low paid domestic services, such as waitresses, bartenders, hospital orderlies, and retail clerks. The kind of jobs that provided ladders of upward mobility into the middle class are being exported abroad or filled by foreigners brought in on work visas. Today when you purchase an American name brand, you are supporting economic growth and consumer incomes in China and Indonesia, not in Detroit and Cincinnati.

In the 20th century, economic growth resulted from improved technologies, new investment, and increases in labor productivity, which raised consumers' incomes and purchasing power. In contrast, in the 21st century, economic growth has resulted from debt expansion.

Most Americans have experienced little, if any, income growth in the 21st century. Instead, consumers have kept the economy going by maxing out their credit cards and refinancing their mortgages in order to consume the equity in their homes.

The income gains of the 21st century have gone to corporate chief executives, shareholders of offshoring corporations, and financial corporations.

By replacing $20 an hour U.S. labor with $1 an hour Chinese labor, the profits of U.S. offshoring corporations have boomed, thus driving up share prices and "performance" bonuses for corporate CEOs. With Bush/Cheney, the Republicans have resurrected their policy of favoring the rich over the poor. John McCain captured today's high income class with his quip that you are middle class if you have an annual income less than $5 million.

Financial companies have made enormous profits by securitizing income flows from unknown risks and selling asset backed securities to pension funds and investors at home and abroad.

Today recession is only a small part of the threat that we face. Financial deregulation, Alan Greenspan's low interest rates, and the belief that the market was the best regulator of risks, have created a highly leveraged pyramid of risk without adequate capital or collateral to back the risk. Consequently, a wide variety of financial institutions are threatened with insolvency, threatening a collapse comparable to the bank failures that shrank the supply of money and credit and produced the Great Depression.

Washington has been slow to recognize the current problem. A millstone around the neck of every financial institution is the mark-to-market rule, an ill-advised "reform" from a previous crisis that was blamed on fraudulent accounting that over-valued assets on the books. As a result, today institutions have to value their assets at current market value.

In the current crisis the rule has turned out to be a curse. Asset backed securities, such as collateralized mortgage obligations, faced their first market pricing in panicked circumstances. The owner of a bond backed by 1,000 mortgages doesn't know how many of the mortgages are good and how many are bad. The uncertainty erodes the value of the bond.

If significant amounts of such untested securities are on the balance sheet, insolvency rears its ugly head. The bonds get dumped in order to realize some part of their value. Merrill Lynch sold its asset backed securities for twenty cents on the dollar, although it is unlikely that 80 percent of the instruments were worthless.

The mark to market rule, together with the suspect values of the asset backed securities and collateral debt obligations and swaps, allowed short sellers to make fortunes by driving down the share prices of the investment banks, thus worsening the crisis. With their capitalization shrinking, the investment banks could no longer borrow. The authorities took their time in halting short-selling, and short-selling is set to resume on October 3 or thereabout.

If the mark to market rule had been suspended and short-selling prohibited, the crisis would have been mitigated. Instead, the crisis intensified, provoking the US Treasury to propose to take responsibility for $700 billion more in troubled financial instruments in addition to the Fannie Mae, Freddie Mac, and AIG bailouts. Treasury guarantees are also apparently being extended to money market funds.

All of this makes sense at a certain level. But what if the $700 billion doesn't stem the tide and another $700 billion is needed? At what point does the Treasury's assumption of liabilities erode its own credit standing?

This crisis comes at the worst possible time. Gratuitous wars and military spending in pursuit of US world hegemony have inflated the federal budget deficit, which recession is further enlarging. Massive trade deficits, magnified by the offshoring of goods and services, cannot be eliminated by US export capability.

These large deficits are financed by foreigners, and foreign unease has resulted in a decline in the US dollar's value compared to other tradable currencies, precious metals, and oil.

The US Treasury does not have $700 billion on hand with which to buy the troubled assets from the troubled institutions. The Treasury will have to borrow the $700 billion from abroad.

The dependency of Treasury Secretary Paulson's bailout scheme on foreign willingness to absorb more Treasury paper in order that the Treasury has the money to bail out the troubled institutions is heavy proof that the US is in a financially dependent position that is inconsistent with that of America's "superpower" status.

The US is not a superpower. The US is a financially dependent country that foreign lenders can close down at will.

Washington still hasn't learned this. American hubris can lead the administration and Congress into a bailout solution that the rest of the world, which has to finance it, might not accept.

Currently, the fight between the administration and Congress over the bailout is whether the bailout will include the Democrats' poor constituencies as well as the Republicans' rich ones. The Republicans, for the most part, and their media shills are doing their best to exclude the ordinary American from the rescue plan.

A less appreciated feature of Paulson's bailout plan is his demand for freedom from accountability. Congress balked at Paulson's demand that the executive branch's conduct of the bailout be non-reviewable by Congress or the courts: "Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion." However, Congress substituted for its own authority a "board" that possibly will consist of the bailed out parties, by which I mean Republican and Democratic constituencies. The control over the financial system that the bailout would give to the executive branch would mean, in effect, state capitalism or fascism.

If we add state capitalism to the Bush administration's success in eroding both the US Constitution and the power of Congress, we may be witnessing the final death of accountable constitutional government.

The US might also be on the verge of a decision by foreign lenders to cease financing a country that claims to be a hegemonic power with the right and the virtue to impose its will on the rest of the world. The US is able to be at war in Iraq and Afghanistan and is able to pick fights with Iran, Pakistan and Russia, because the Chinese, the Japanese and the sovereign wealth funds of the oil kingdoms finance America's wars and military budgets. Aside from nuclear weapons, which are also in the hands of other countries, the US has no assets of its own with which to pursue its control over the world.

The US cannot be a hegemonic power without foreign financing. All indications are that the rest of the world is tiring of US arrogance.

If the US Treasury's assumption of bailout responsibilities becomes excessive, the US dollar will lose its reserve currency role. The minute that occurs, foreign financing of America's twin deficits will cease, as will the bailout. The US government would have to turn to the printing of paper money as did Weimar Germany.

For now this pending problem is hidden from view, because in times of panic, the tradition is to flee into "safety," that is, into US Treasury debt obligations. The safety of Treasuries will be revealed by the extent of the bailout.

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