Artificial Savings

Description

By Jeanne M. Haskin

There are two ways that a neoliberal economy can mask decades of flat or falling wages and little or no savings. The first is to have a strong dollar in relation to other currencies, which makes imports less expensive. The ability to buy more with less helps to sustain the illusion of economic wellbeing, particularly with respect to durable and nondurable goods manufactured in other countries. It allows households to afford appliances and technology, toys, clothing, and footwear, all of which speak to our need for basic comforts. For many, the perception of saving on what is bought, replaces money that is saved to buy. Coupled with consumer credit, this encourages negative savings, thereby increasing the debt of households and leveraging consumption against future wages. The second way to provide the illusion of growth is to have an economic boom period wherein demand for homes and rental properties becomes strong enough to push up prices. When real property is not owned outright but mortgaged, the upward surge in prices lowers the debt to value ratio. The outcome is more equity, or an increased percentage of ownership, which encourages property owners to sell high and upgrade to more expensive properties or cash in on the extra value with a home equity loan to fund more consumer spending. In either case, property owners increase their debt based on the perception of asset-savings, which is really the illusive incentive of a market fluctuation.

Not All Debt is Created Equal

Unfortunately, the persistence of flat or falling wages and little to no real savings means that even though tricks of the market allow consumers to upgrade their standard of living, their debt to income ratio is steadily increasing. Built into every mortgage, home equity loan, or use of consumer credit is the true valuation of a consumer's ability to pay based on leveraged wages. The risk factor of inelastic earnings, coupled with the inevitability of a market correction (or economic downturn, otherwise known as the "bust" phase of the American business cycle), often translates into higher costs of credit, mandatory mortgage insurance and/or disability insurance, as well as greater fees for origination, underwriting, and closing. Too, homeowners who upgrade or have property reappraisals will pay higher property taxes. As such the degree of leverage may be unsustainable in the long-term, particularly when a market correction decreases property values, inspires employer cutbacks, puts people out of work, and ensures that their new jobs will pay lower wages. In that event the pressure to maintain household payments motivates consumers to take on second and even third jobs on terms that are disadvantageous. For industry, this provides a cornucopia of hiring prospects to choose from and a greater power to ensure that employees remain motivated, no matter the terms of employment.

Homeownership in Historical Perspective

For those who were able-bodied workers and soldiers during WWII, the pent-up real savings created by two working family members at a time of rationing and scarcity ensured that post-war America would experience a housing boom on terms and conditions that were far different from those we know today.

In the first place, the manufacturing sector switched from a wartime footing that overwhelmingly supplied the government to produce for a starved domestic market and reconstruction overseas. In the second place, not all women reverted to a primary focus on homemaking although returning soldiers were expected and even aided to take over women's wartime jobs.

According to historian Elaine Tyler May:

Most [women] wanted to continue working after the war ended. But, of course, millions of men came back from serving in the military and there was a widespread fear that there would be another depression once the wartime economy shut down. Women were asked to do their part by leaving the job market. Many were fired from their jobs so the returning veterans could be re-employed…[But] women were still employed as secretaries, waitresses, or in other clerical jobs…because they either wanted or needed to keep working.[1]

Households with forced savings and often two working members absorbed the feverish spread of modestly-modeled housing made even more attractive by one-dollar-down mortgages and preferential loans for Veterans. Couples could also afford to marry, have children, and purchase durable goods.

The difference between the baby boom generation that escaped the Great Depression and the generations that followed is that those who experienced WWII were a nation of savers first.

In Russ Roberts' words:

[W]orld War II led to a "glut" of private savings because (1) government spending caused full employment, but (2) workers and businesses were forced to save much of their income because the massive shift of output toward the war effort forestalled spending on private consumption and investment goods. The resulting cash "glut" fueled post-war consumption and investment spending.[2]

In other words, government restraints on consumption produced conservatism and thrift. Only after the war was over did the consumer floodgates open as manufacturers free of profit restrictions scrambled to meet and fuel the increasing tide of demand.
Too, the empowerment of unions under FDR ensured that wages, working hours, and benefits were conducive to a better than modest standard of living.
As such, aging baby boomers do not understand the generations that have steadily lost these benefits and are spenders rather than savers.

Trying to Recapture the Past

Under President Jimmy Carter, the nation was asked to voluntarily embrace a return to wartime-like austerity because the economy that Carter inherited both during and after the OPEC oil shocks was plagued by stagflation. This meant that the costs of all goods and services were increased by the oil price hikes. Pay raises that allowed workers to accommodate price inflation in turn sparked more inflation. As wages chased after prices with no appreciable increase in sales and production, this meant that profits suffered and the economy was moribund. GDP was stagnant, and debtors came out ahead of savers since purchases made on fixed-interest credit were paid back with inflated, or increasingly discounted, dollars.
Those who pointed to Weimar Germany[3] and the real danger of increasingly worthless money were not shy of predicting catastrophic consequences. Indeed the collapse of government occurred at least

symbolically when Carter returned from his emergency Camp David conference to demand resignations from most of his cabinet members.
Those who replaced the outgoing members were chosen largely for loyalty. As Carter went on to address the nation, he promised to cut government spending and scale back the government workforce to stop government borrowing from crowding out private credit and to balance the federal budget. He also called on workers and producers to cap pay raises and price hikes, saying:

In the last 10 years, in our attempts to protect ourselves from inflation, we've developed attitudes and habits that actually keep inflation going once it has begun. Most companies raise their prices because they expect costs to rise. Unions call for large wage settlements because they expect it to happen; it does happen, and once it's started, wages and prices chase each other up and up…Except for our lowest paid workers, I'm asking all employees in this country to limit total wage increases to a maximum of seven percent per year. From tonight on, every contract signed and every pay raise granted should meet this standard. My price limitation will be equally strict. Our basic target for economy-wide price increases is five and three quarters percent. To reach this goal, I'm tonight setting a standard for each firm in the nation to hold its price increases at least one-half of one percentage point below what they averaged during 1976 and 1977.[4]

Still later, Carter decried the empty values of a consumption-driven society and urged a return to spiritualism to overcome what he called the nation's crisis of confidence. He said:

In a nation that was proud of hard work, strong families, close-knit communities, and our faith in God, too many of us now tend to worship self-indulgence and consumption. Human identity is no longer defined by what one does, but by what one owns. But we've discovered that owning things and consuming things does not satisfy our longing for meaning. We've learned that piling up material goods cannot fill the emptiness of lives which have no confidence or purpose.[5]

Imposing consumer restraint to restore the value of money became the number one priority. As William Greider noted:

President Carter and a Democratic Congress enacted the Monetary Control Act of 1980 which removed all remaining controls on interest rates and repealed the federal law prohibiting usury (note that sky-high interest rates and ruinous predatory lending have been with us ever since).[6]

Meanwhile, Paul Volcker, Carter's chairman of the Federal Reserve, hiked interest rates to unprecedented levels both to encourage savings and to afford the wealthy protection. The cost of money lent skyrocketed both in and outside of America, reaching a prime rate of 21.5% in December 1980—the highest rate in U.S. history.[7]
At the same time, high interest rates diverted investment from the stock market to the bond market. If the government wanted to borrow, it would do so at higher costs. As it was, the carrying cost of outstanding U.S. debt grew ever greater. Hence fiscal austerity was vital to Carter's leadership, the largest part of which depended on energy conservation. Carter proposed to weather the OPEC shocks by regulating thermostats, installing solar panels, insulating buildings, and exploiting clean coal and natural gas as sources of domestic energy. Carter's concern with the rising costs of health care also persuaded health care providers and insurers to experiment with different coverage models.
Finally, Carter deregulated the airline, rail freight, and trucking industries to produce competition that successfully lowered rates.
In all, Carter's presidency led to an important turning point. A self-reliant America required more

competition and sacrifice. Beginning with Ronald Reagan (who fired the on-strike air traffic controllers), unions and middle management would be worn down or phased out over time and never again would wage inflation exceed a minimal percentage.
Above all, it would no longer matter whether a Republican or Democrat ascended to the White House. As Richard Posner put it:

Deregulation was bipartisan. It is entirely speculative to suppose that, had Carter been reelected, the deregulation of banking, including the relaxation of mortgage standards, would have ceased. When the Democrats regained the presidency in 1993, banking deregulation continued, culminating in the repeal of the Glass-Steagall Act, which had split commercial banks from investment banks, and in the rejection of regulation of the new derivatives, notably credit-default swaps. Robert Rubin and Lawrence Summers, Clinton’s principal economic advisers, were steadfast supporters of banking deregulation. They are both Democrats.[8]

In sum, whether Democrat or Republican, political pandering to Wall Street and the advancement and protection of the wealthiest banks became paramount to legislators.

Asset-Backed Lending and the Battle for Market Share

In the manufacturing sector, the protection of wealth required outsourcing production to undermine unions while employing cheaper labor to increase profit margins. The migration of America’s productive facilities also meant that their real assets of property, plant, and equipment vanished from the U.S. landscape. Left with a service economy that creates or destroys wealth from nothing but market fluctuations, the big banks took an increasingly competitive stance on increasing their share of asset-savings, beginning with home and property mortgages (or what remained of collateralized debt, excluding, for the moment, the market for auto financing).
That said, the banks were faced with a choice. They could undercut the Savings & Loan industry, which, on average, held 53% of all home mortgages, by charging lower mortgage interest. Or they could woo customers away from the thrifts with Certificates of Deposit (CDs) and other savings instruments that paid higher interest in the hope that customers would also move their mortgages once bank loyalty was established. Alternatively, the banks could have paid out high interest and lowered mortgage rates, but this was a losing gambit that could not have persisted indefinitely.
The solution? Disaster capitalism.

Why Compete When You Can Pillage?

The term “disaster capitalism,” as used by Naomi Klein and coined by News Junkie Post editor Gilbert Mercier applies to any profitable destruction that offers more profit in the aftermath. This was the lesson of WWII, which put America back to work and ensured in the aftermath that American goods and services would be provided by the Marshall Plan. From a purely financial perspective, it means blowing up our own industries through deregulation that builds up risky loan portfolios and then breaks them down through unsustainable debt—a necessarily piecemeal strategy in terms of the actual goal, i.e., capturing all asset-savings and/or property-based collateral from the big banks’ other competitors (of which the thrifts were only one) because the destruction of the S&Ls had to be decisive. More than one sector crash, bailout, and sellout could not be sold to the public (at least in earlier presidencies) nor could the bankers run the risk of upsetting the whole economy.
So, under President Carter, the big banks set their eyes on the prize of the Savings & Loan industry. Once the administration deregulated interest rates and repealed the law on usury, the S&L’s, which

primarily made long-term fixed-rate mortgages, suffered a loss in mortgage value. Essentially, the higher interest rates wiped out the S&L's net worth.[9] "In 1983 it was estimated that it would cost roughly $25 billion to pay off the insured depositors of failed institutions. But the thrifts' insurance fund, known as the FSLIC, had reserves of only $6 billion."[10]
The point of deregulation was supposedly to make the S&Ls competitive. By allowing the thrifts to pay more interest to depositors and engage in a broader range of banking services, the government would solve the S&L's problem by virtue of sheer growth. Or so the argument went. In practice, it was, and should have been, obvious that the existing loan portfolios of long-term fixed-rate mortgages would force losses to mount because they were not renegotiable. This was the millstone around the necks of the thrifts, even though they raised deposit-interest to attract more depositors.

Burning the Candle at Both Ends

What higher interest rates did do was open the door to looting the thrifts.
As William Greider put it:

It was the 1980 legislation that took the lid off banking and doomed the savings and loan industry, the mainstay that used to provide housing loans and home mortgages. The thrifts were able to raise capital because they were allowed to pay a half percent more in interest to depositors. Bankers wanted them out of the way. The Democratic party obliged.[11]

Why? According to Kenneth J. Robinson:

S&Ls have their origins in the social goal of pursuing homeownership…These institutions were originally organized by groups of people who wished to buy their own homes but lacked sufficient savings to purchase them. In the early 1800s, banks did not lend money for residential mortgages. The members of the group would pool their savings and lend them back to a few of the members to finance their home purchases. As the loans were repaid, funds could then be lent to other members…In 1980, there were almost 4,000 thrifts with total assets of $600 billion, of which about $480 billion were in mortgage loans (FDIC). That represented half of the approximately $960 billion in home mortgages outstanding at that time (Board of Governors 2013).[12]

In other words, the demise of the thrifts was planned both because they were socially-oriented and because of their market share. "Federally-chartered S&Ls were granted the authority to make new (and ultimately riskier) loans other than residential mortgages."[13] The result was overleveraged portfolios blown up by self-dealing to S&L employees, friends, associates, and relatives, most of whom were unqualified. However, the rape of the S&L's also had criminal origins. A New Yorker named Mario Renda, who, according to his federal deposition, worked in conjunction with the Mob, "brokered as much as $5 billion per year in deposits into 130 S&Ls across the country, all of which failed."[14]
According to author Jonathan Kwitny:

[M]any of the deposits were made on the specific condition that the S&Ls would lend money out to borrowers Renda would recommend, who turned out to be local Mafia people or strangers from out-of-state.[15]

Because money had to be driven into the thrifts for the rape to take effect, other deposit-brokers engaged in a similar scam known as "linked-financing." These deposit-brokers steered deposits to the thrifts under a preexisting agreement to loan to certain people, who then remitted the loan money

directly to the deposit-broker.[16]
Apart and aside from this, politically-connected luminaries Neil Bush and Jeb Bush benefited from loan transactions where money was siphoned off fraudulently or the loans were made for speculative investments without provisions to secure repayment if the venture proved unprofitable.[17]

Why Die Small When You Can Go Big?

When alarms were initially raised in 1983, the thrifts could have been rescued for $19 billion. Instead, Congress let it ride until 1989, when it passed the Financial Institutions Reform, Recovery and Enforcement Act, which created the Resolution Trust Corporation (RTC) to dismantle the S&Ls.

The RTC closed 747 S&Ls with assets of over $407 billion. [By then] the ultimate cost to taxpayers was estimated to be as high as $124 billion.[18]

The total amount of the bailout, however, was nowhere near this modest. According to Stephen Pizzo's Inside Job and Pete Brewton's Untold Story, the total cost to U.S. taxpayers was an estimated $500 billion.[19] Congress then pushed the RTC to dispose of the thrifts' surviving assets in a firesale, where investors squeezed the public via the RTC.
As Nomi Prins reports:

At the first RTC auction in Dallas in July 1991, assets worth $25 million sold for 20 cents on the dollar. In May 1992, another RTC auction sold assets for only 17 cents on the dollar. By December 1995—the last year of the RTC's existence—prices barely reached 70 cents on the dollar. So eventually the assets did regain some value, but only after enough were sold at exceedingly low prices, which had the effect of rendering the remaining assets more valuable.[20]

In sum:

[T]he RTC…sold off $519 billion worth of assets for 1,043 thrift closings. But the RTC never brought the profits to the American people…Instead it left the public on the hook for $124 billion in losses,[21] while the thrift industry lost another $29 billion.[22]

The Test Becomes the Template

Naturally, the point of blowing up the thrifts was to make money coming and going. What tends to be overlooked is that the genius of bailout money is to free banks from depending on savers while holding down society's wages. The inability to save (and its undesirability in a consumption-driven society that must push for negative savings to maintain constant growth) is solved not by raises but by government-sanctioned theft. It can't be called redistribution because the underlying behavior is criminal in nature. When the government bails out fraud, complete with its firesale of assets, it closes the circle of crime with a yet another crime and calls it legislation. Worse, it sets the example for future action that must be even more egregious in terms of fraud and sector penetration to make the next bailout more than a compulsion.
In terms of the bottom line, a repeat-performance was truly irresistible because banks in collusion with government contrived to extract billions of dollars from ordinary citizens while cutting them out as the "middlemen" or rightful earners of capital.
The question then becomes: why not try for trillions?

Notes:

[1] May, Elaine Tyler, “Women and Work,” http://www.pbs.org.wgbh/amex/tupperware/sfeature/sf_women.html.

[2] Roberts, Russ, “Does ‘Pent Up’ Demand Explain the Post-War Recovery? https://politicsandprosperity.com/2011/07/26/does-pent-up-demand-explain-the-post-war-recovery/

[3] LaRouche, Lyndon H., Jr., “Jimmy Carter’s economy enters into ‘Weimar hyperinflation,’” *Executive Intelligence Review*, March 25-31, 1980.

[4] Jimmy Carter, “Anti-Inflation Program,” 24 October 1978. *Vital Speeches of the Day*, Vol. XLV, No. 3, November 15, 1978, pp. 66-69.

[5] http://www.pbs.org/wgbh/americanexperience/features/primary-resources/carter-crisis/

[6] Leonard, Andrew, “No, Jimmy Carter did it,” *Salon,* June 4, 2009, http://www.salon.com/2009/06/04/jimmy_carter_did_it

[7] “Presidency of Jimmy Carter,” Wikipedia, p. 6,

[8] Leonard, Andrew

[9] Robinson, Kenneth J., Federal Reserve Bank of Dallas, “Savings and Loan Crisis 1980-1989.”

[10] Ibid.

[11] Leonard, Andrew

[12] Robinson, Kenneth.

[13] Ibid.

[14] Scheim, David E., “Trust or Hustle: The Bush Record,” http://www.campaignwatch.org/more1.htm.

[15] Ibid.

[16] “Savings and Loan Crisis,” Wikipedia, p. 3.

[17] Scheim, David E.

[18] Robinson, Kenneth

[19] Scheim, David E.

[20] Prins, Nomi, *It Takes a Pillage,* (New Jersey: John Wiley and Sons, 2009), p. 117.

[21] This figure comes from the Fed, which downplayed the losses, in contrast to later research that placed the number at $500 billion.

[22] Ibid.