Bush on the financial crisis: “Wall Street got drunk”

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On July 23 the *New York Times* published a brief account of President George W. Bush’s comments on the struggling US economy to an invitation-only fund-raiser in Houston. The July 18 event was held at a private home to benefit Pete Olson, the Texas Republican who is challenging Democratic Representative Nick Lampson. The comments were recorded by a local ABC television station and broadcast, despite Bush’s verbal request that journalists in attendance turn off their cameras.

The *Times* wrote: “When he talks about why the economy is ailing, President Bush often turns to euphemism, citing ‘challenges in the housing and financial markets.’ But Mr. Bush offered a far blunter assessment last week at a closed Republican fund-raiser in Houston.”

The article continued: “‘Wall Street got drunk—that’s one reason I asked you to turn off your TV cameras,’ the president said. ‘It got drunk, and now it has a hangover. The question is, how long will it sober up and not try to do all these fancy financial instruments?’”

There is much to be said about the glimpse the incident allows of the modus operandi of the US political elite. Bush and his handlers feel that open, public discussion of basic policy would have dangerous consequences—an appraisal no doubt based both on polls of ordinary Americans and warnings on the nervous state of financial markets. They have come to rely on the “free press” to censor opinions that would be impolitic to reveal to the general population.

The incident also reveals Bush’s extremely limited understanding of the financial crisis shaking the US and his own administration. He glibly presents it as a temporary aberration, attributable to an intoxication with “fancy financial instruments.” This not only vastly underestimates the depth of the crisis, it ignores the deep-rooted tendencies in US capitalism that have led the financial industry to adopt exotic and outright fraudulent ways of packaging its products, and the role of successive administrations, including his own, in facilitating such reckless forms of speculation.

Investments of trillions of dollars in new financial instruments have undoubtedly played a key role in triggering the current economic downturn. A flood of dubious mortgage-backed securities led to a housing bubble whose bursting undermined credit markets. But speculation in housing was only part of a far broader explosion of financial manipulation, including a vast and unregulated market in “derivatives,” including credit default swaps and other means by which banks, hedge funds and other major investors hedged their bets.

The result is a financial crisis on a scale not seen since the Great Depression, precipitating a sharp jump in joblessness and soaring prices for basic commodities such as gasoline and food.

Bush’s ignorant and cynical remark is an evasion of the central issue exposed by the Wall Street crisis: the colossal growth of economic parasitism and criminality in the workings of American capitalism. This process, which has unfolded and accelerated over the past three decades, is the reverse side of the systematic dismantling of America’s once mighty industrial base. The present crisis is the outcome of the American bourgeoisie’s increasing separation of the means by which it amasses its wealth from the production of real value.

This process is not a mere aberration, nor is it new. It is a malignant expression of the decline in the global economic position of American capitalism and is rooted in a protracted crisis of profitability in basic industry.

It has proceeded at every point with the full support of the American political establishment and both parties of US big business. The Democratic Carter administration took a major step in facilitating the growth of financial speculation by launching the assault on government regulation of business with its program of deregulation of the commercial air and trucking industries. Carter, in 1979, appointed the Wall Street banker Paul Volcker to head the Federal Reserve Board, with a mandate to wring inflation out of the economy by jacking up interest rates and precipitating the deepest recession since the 1930s.

The shutdown of unprofitable sections of basic industry and mass layoffs were used to weaken the working class and undermine its militancy. This was a calculated class-war policy, inaugurating a ruling class offensive against workers that has continued ever since.

Reagan, with Volcker still at the helm of the Fed, intensified the anti-working class offensive, initiating a wave of union-busting and wage-cutting by smashing the air traffic controllers’ strike and firing and blacklisting some 11,000 members of the PATCO union. The anti-union offensive, together with unprecedented cuts in social spending, the gutting of environmental, health and safety and other regulations that had limited corporate profit-making, and tax cuts for the wealthy, facilitated the increasing turn by corporate America to forms of speculation divorced from manufacturing. This growth of financial parasitism was promoted as an assault on “big government” and justified with endless invocations of the virtues and infallibility of the “free market.” The entire process was aimed at funneling an ever greater share of the social wealth into the coffers of the financial elite—and it succeeded in doing precisely that.

Among the more significant deregulatory measures carried out by the Carter and Reagan administrations were the 1980 Depository Institutions Deregulation and Monetary Control Act and the 1982 Garn-St. Germain Depository Institutions Act. These loosened restrictions on bank mergers and on the interest rates banks—particularly smaller savings and loans institutions

(S&Ls)—could charge, notably on mortgages.

Financial institutions scrambled to create the most profitable methods of cashing in on high interest rates and the flood of cash accruing to the wealthy. Collateralized mortgage obligations (CMOs) were first created in 1983 by investment banks and Wall Street firms. They were packages of large numbers of mortgages, portions of which could be bought and sold, giving their owners the right to a corresponding share of the payments from all the mortgage debtors in the package.

Financial derivatives—instruments whose values depend on the value of an underlying commodity, stock or other asset—also took off during the 1980s. Futures contracts for agricultural commodities—allowing farmers to lock in prices and speculators to place bets on the movement of farm prices—had existed since the 19th century, and contracts depending on the movement of currency exchange rates were created in the 1970s. However, in the 1980s such contracts spread to cover stocks, interest rate movements, energy prices, and the prices of other commodities. They were largely traded in unregulated, so called over-the-counter markets.

The unviability of this speculative financial activity soon became apparent. A massive crash in October 1987 wiped out 23 percent of the stock market's value in one day. Failures of S&Ls reached epidemic proportion, and in the late 1980s the US government organized a bailout, costing approximately $160 billion. In an attempt to stabilize the financial system, US regulators increased the proportion of total capital that banks had to keep as cash reserves.

The ensuing economic upswing depended to a large extent on the easy credit policies of the Federal Reserve, which encouraged further speculative bubbles.

Collateralized mortgage obligations (CMOs) first became widely used in the early 1990s. Total issuance of CMOs from 1990 to 1994 hit $1 trillion. CMOs—like similar mortgage-backed financial instruments created more recently—were legally independent entities that did not have to be counted on banks' balance sheets, allowing banks to evade capital requirements imposed by regulators after the S&L crisis. Banks instead made loans and realized hefty profits from selling CMOs to other investors.

Steven Pearlstein of the *Washington Post* explained this shift in a 2007 column, writing: "In the simple model of yesteryear, a bank would essentially borrow money from its depositors and lend it to households or businesses that needed loans. For every dollar it lent out, however, the bank was required to set aside some of its money in reserve to cover losses it might suffer if some loans were not repaid. But all that went out with deregulation and the rise of financial engineering. [...] Most of the loans [big banks] make do not remain on their books, but are immediately packaged with other loans and sold to buyers such as hedge funds."

The early 1990s also saw a significant de facto deregulation of futures markets. Until then, the Commodity Futures Trading Commission (CFTC) had limited the number of commodity futures an individual investor could buy, in order to prevent sudden market shifts from destabilizing commodity prices. However, in 1991 the CFTC began granting exemptions to these rules for major investors such as Wall Street firms and pension funds.

There followed the dot-com stock market bubble, which crashed in 2001, quickly succeeded by the now-imploded housing bubble. One of the most important legal changes enabling the inflation of a gigantic housing bubble was the 1999 repeal, under Democrat Bill Clinton, of the 1933 Glass-Steagall Act, which had separated commercial banking (involving depositors' money) from investment banking. This deregulatory measure allowed commercial banks to become large-scale issuers of mortgage-backed securities.

The scale of the current crisis is far greater than those of the 1980 and 1990s. The sums involved in market speculation in the US and worldwide have grown almost exponentially, while industry in the major industrialized countries has continued to shrink. Consumer spending, which accounts for some 70 percent of US gross domestic product, has been sustained, in the face of declining real wages, largely by an immense growth of household and consumer debt.

According to a 2007 study by the McKinsey consulting firm, the total value of world financial assets went from $12 trillion in 1980 (109 percent of a world gross domestic product of $10.1 trillion) to $43 trillion in 1990 (201 percent of world GDP), to $94 trillion in 2000 (294 percent of GDP), to $167 trillion in 2006 (346 percent of world GDP).

The value of US mortgage, futures and derivatives markets has surged. Outstanding US mortgages are valued at approximately $12 trillion. According to the *Wall Street Journal*, over-the-counter commodity futures markets have a value of $9 trillion, and regulated commodity futures markets are valued at $4.78 trillion—up 1000-fold from a total value of $4 billion in 1976.

At the same time, workers' share of GDP has fallen sharply. According to data from the Organization for Economic Cooperation and Development, workers' share of GDP in the OECD countries fell from a high of 75 percent in 1975 to 68 percent in 1990 and 66 percent in 2005. US workers were shifted from higher-paid manufacturing jobs to service work, as 5 million manufacturing jobs were lost from 1979 to 2006 and manufacturing's share of the labor force went from 20 to 11 percent.

Since it came to power in 2001, the Bush administration has presided over a further growth of financial speculation. The bursting of the housing bubble has already led to massive movement of speculative capital into commodity futures markets, providing a major impetus to the explosion of oil prices from $60 to $140 a barrel and leading to surges in grain prices that have destabilized world food markets.

Bush himself has personal connections to corporations that profited enormously from unregulated financial instruments. Enron, whose CEO Ken Lay was a key Bush supporter, made significant use of energy derivatives markets in its 2000-2001 manipulation of the California electricity market.

The collapse of the housing bubble, the inevitable outcome of the orgy of speculation fueled by subprime loans, has immense ramifications, threatening a replay of the S&L collapse of the late 1980s on a far larger scale. The Federal Reserve has already had to organize the March 2008 bailout of investment bank Bear Stearns. Now even larger entities—major commercial banks like Citibank, Royal Bank of Scotland and UBS, and US mortgage agencies Fannie Mae and Freddie Mac—are threatened by the collapse of the mortgage bubble, placing the viability of the world financial system in question.