

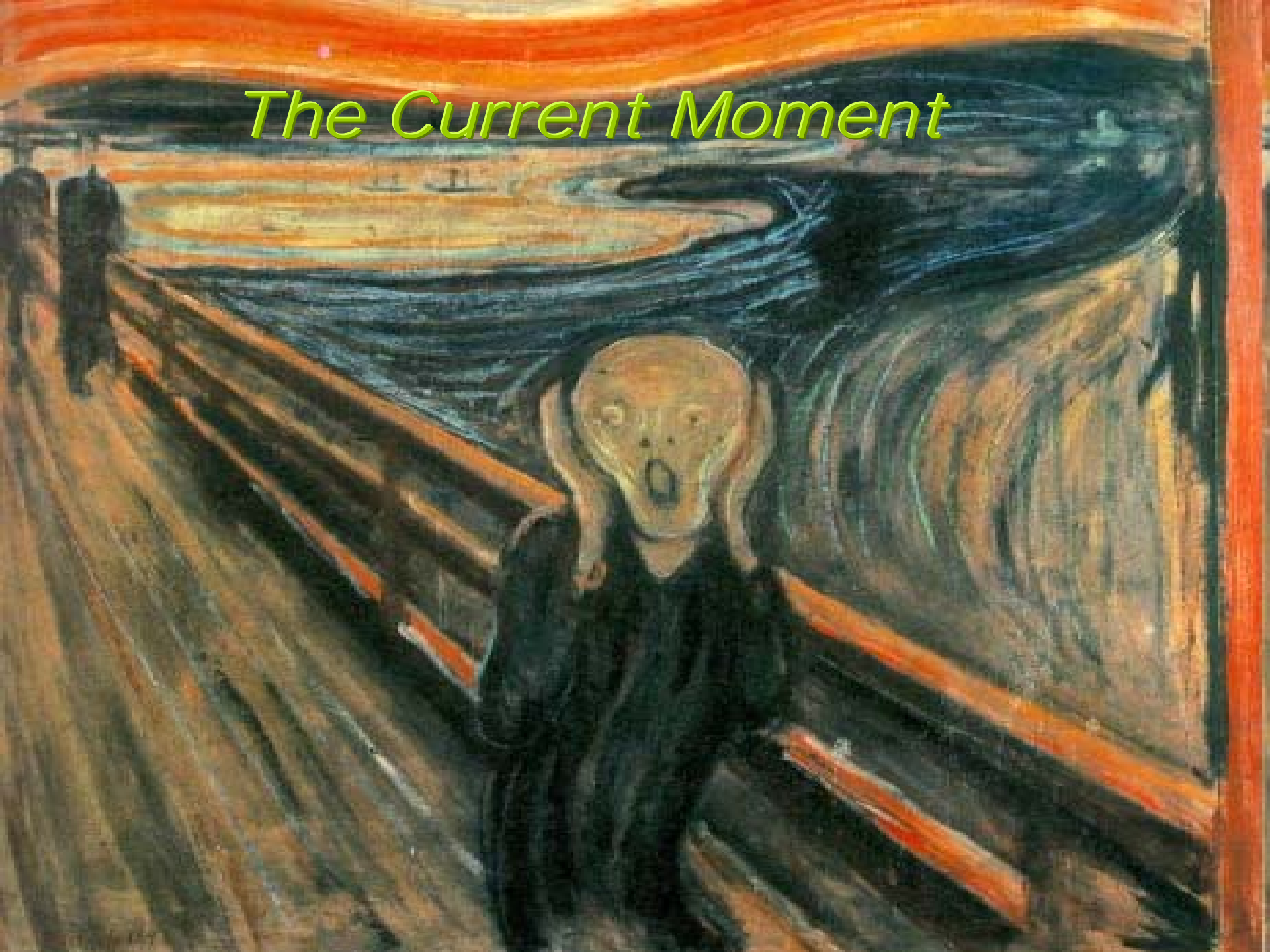
*The Economic Crisis:  
How Did We Get Into It?  
How Can We Get Out of It?*

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**Evergreen State College**

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*The Current Moment*



# *The Current Moment, In Particular*

Finance: from illiquidity to insolvency

Business: a cascade of bankruptcies

Trade: plummeting

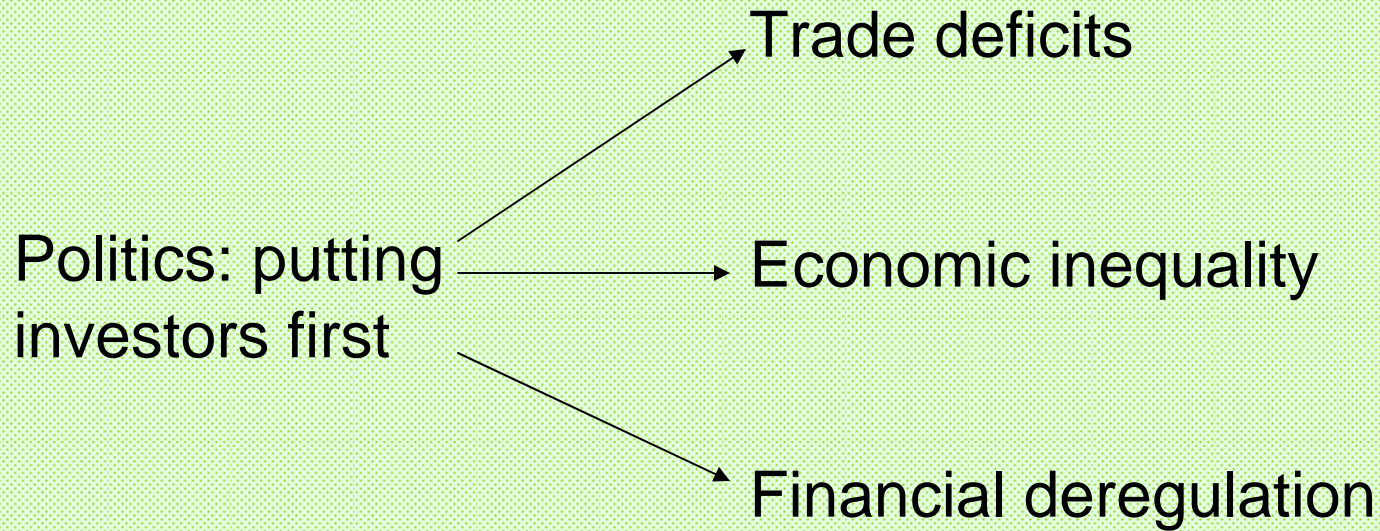
Unemployment: aiming toward double digits

Housing: a wave of foreclosures

Currencies: countries approach default

Prospects: unknown

# *How Did We Get Into This?*



# *Sidebar: Three Kinds of Deficits*

Fiscal deficit

borrowing by government

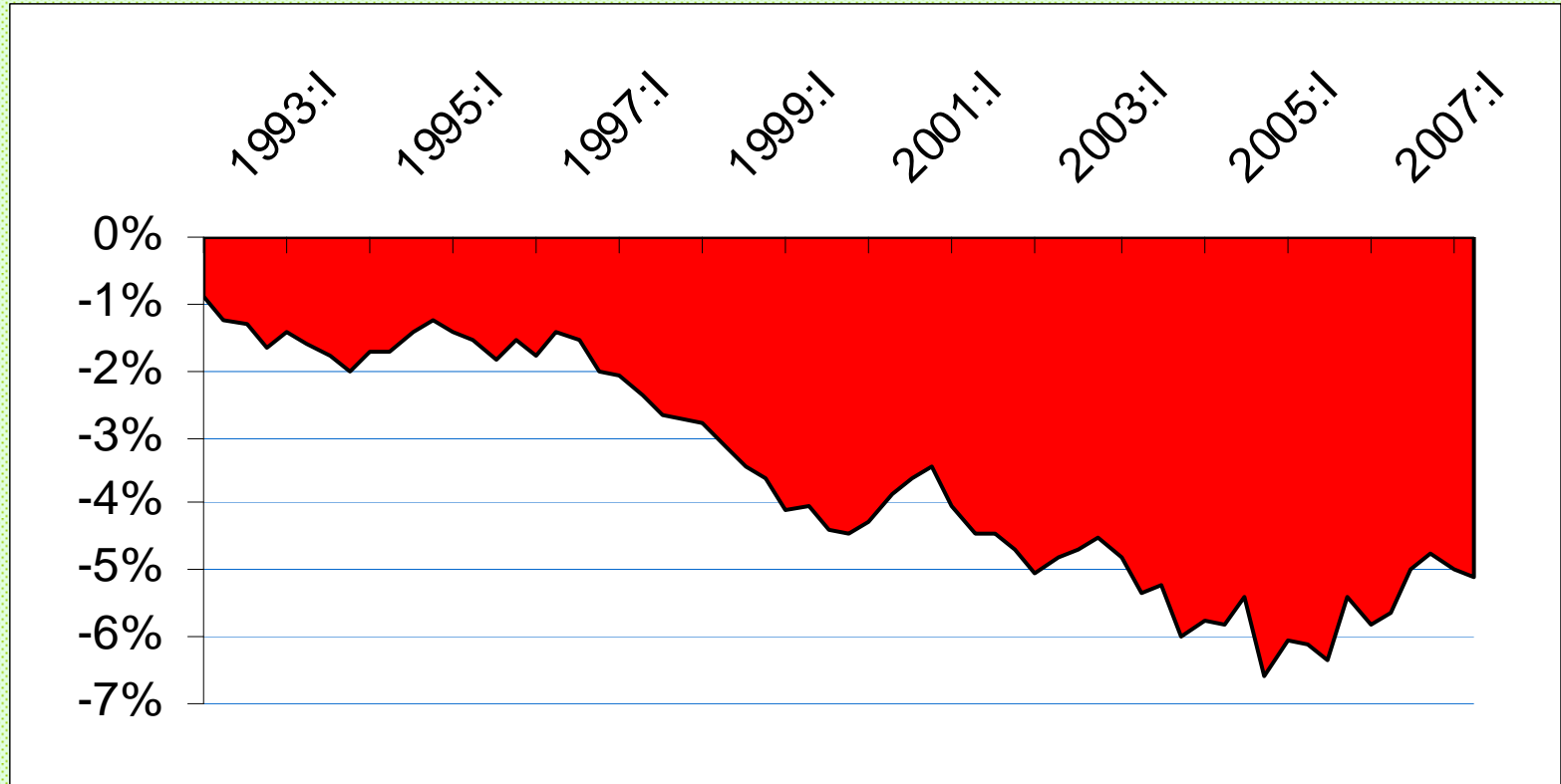
External deficit

borrowing by country from rest  
of the world

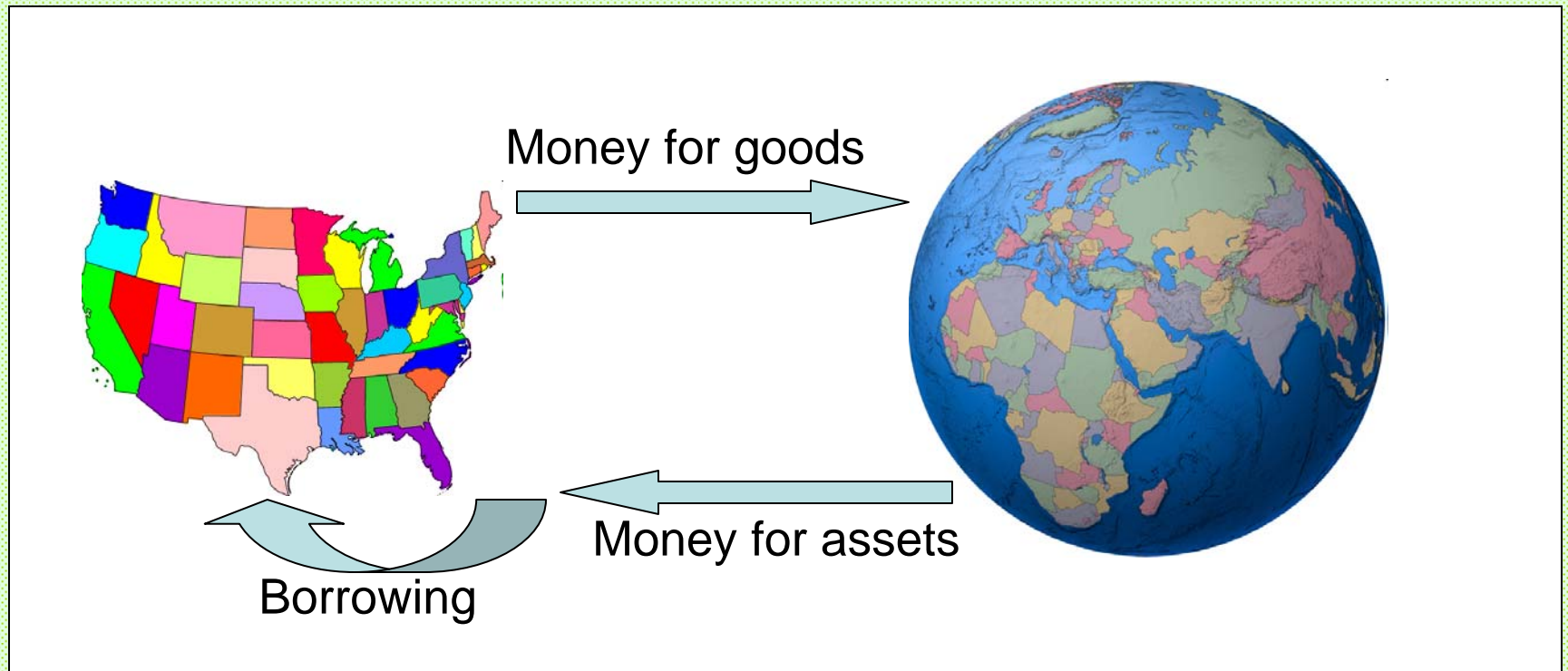
Private debt

borrowing by households and  
businesses

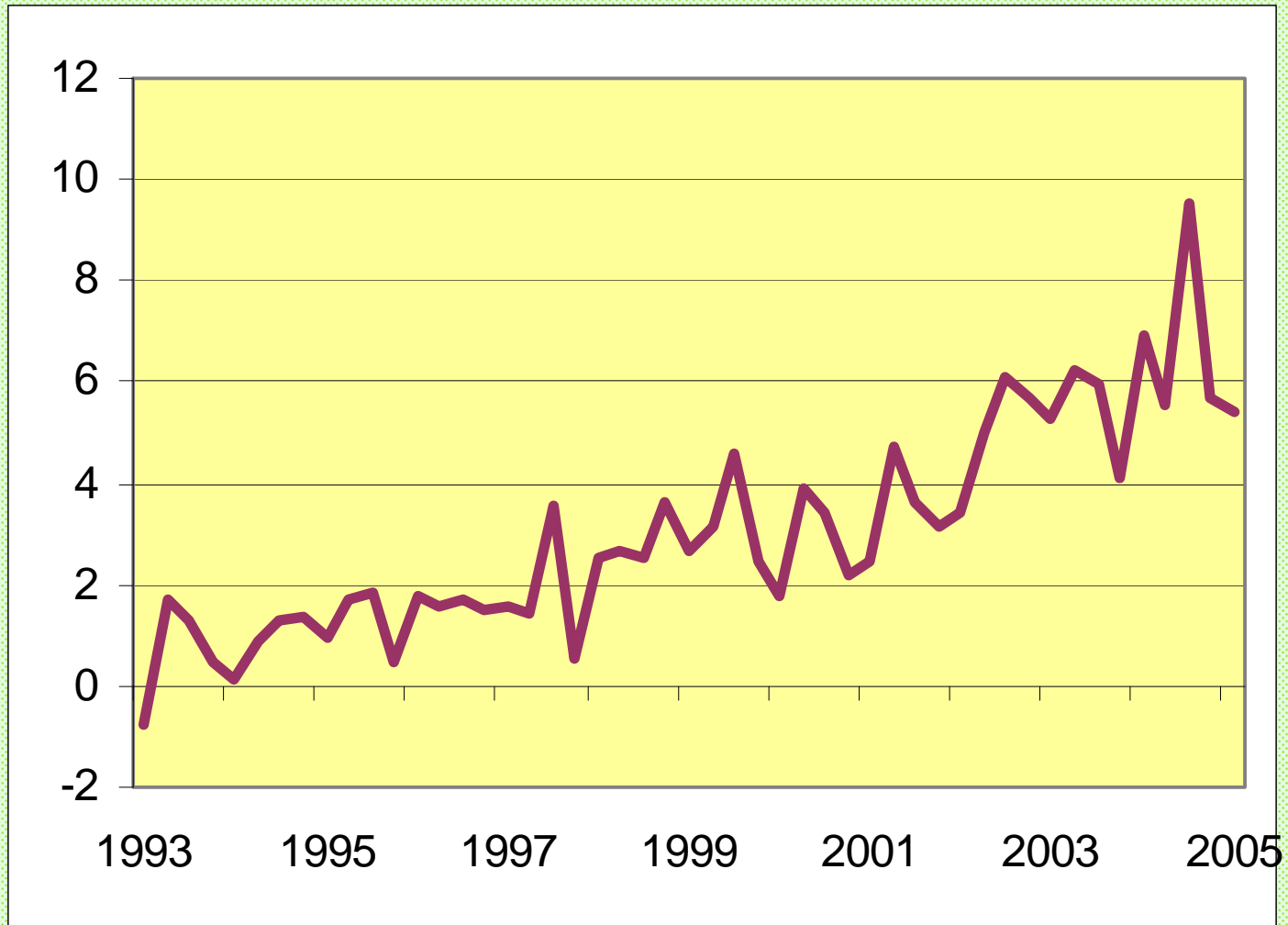
# *US External Deficit*



# *Recycling the External Deficit*



# *Mortgage Equity Extraction as a Percentage of Disposable Income*



# *Economic Inequality*

Average income growth, bottom 99%, 1993-2006: **1%**

Average income growth, top 1%, 1993-2001: **6%**

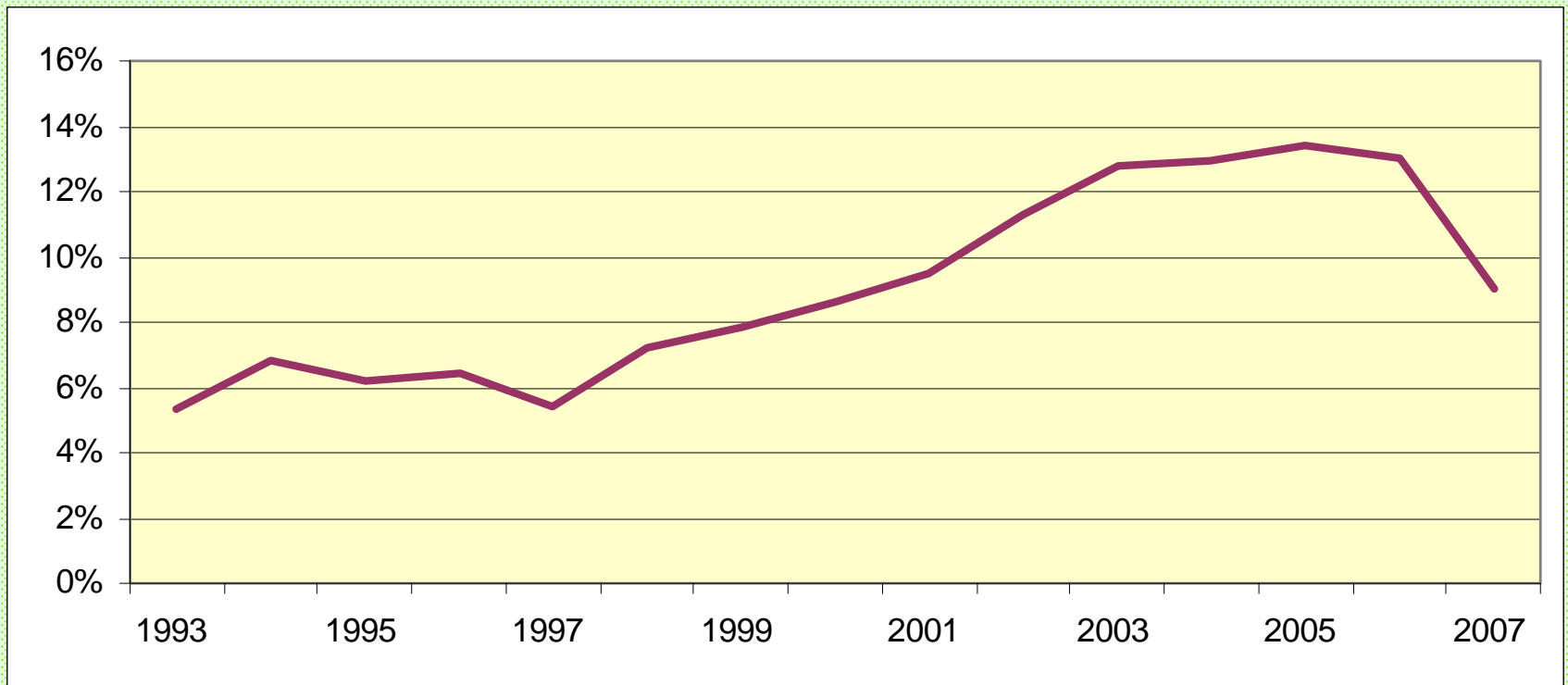
Average income growth, top 1%, 2002-2006: **10%**

Fraction of total income growth going to top 1%, 1993-2001: **50%**

Fraction of total income growth going to top 1%, 2002-2006: **75%**

Wall St. bonuses, 2006 + 2007, compared to the combined wage increase for all production and nonsupervisory workers, 2002-2007: **greater**

# *Household Borrowing as Percent of Consumption*



# *Financial Deregulation*

Deregulation by default

Leverage unlimited

Competitive complexity

# *The Political Underpinning*

The principle: all impediments that prevent investors from obtaining the highest possible rate of return should be removed.

The theory: “neoliberal” economics

The beneficiaries: the top 20%, the top 1%

The specifics:

- global freedom for investors

- businesses as a portfolio of saleable assets,

- financial deregulation

# *The Bailouts*

Who: the US Treasury Department (Paulson)  
the Federal Reserve System (Bernanke)

How: buy doubtful assets in exchange for US debt  
supply capital to banks  
make loans to financial institutions (and GM?)  
directly supply credit to businesses  
purchase debt in secondary markets  
guarantee investors against losses

# *Financing the Bailouts*

The approximate cost so far:

\$1.25T in direct expenditures

\$8T in commitments

The revenue sources:

\$400B in Fed reserves

\$400B in new reserve creation

\$400B in Treasury debt

(plus additional debt to finance the external deficit)

# *The Bailout Strategy*

Initially: supply liquidity

Then: defray losses

In effect: government debt replaces private debt

What we don't know:

- total losses

- the fraction needed to be covered to restore confidence

# *Risks to the Bailout Strategy*

No one knows how much bailing is required.

The bailout absorbs funds that could be used for lending.

Why should banks lend?

Feedback from the failing economy to the financial system.

Resources are not unlimited: the potential for a dollar crash.

“Good” scenario: after the bailout succeeds.

“Bad” scenario”: before it succeeds.

# *There Are Alternatives*

Stop the bailouts.

Establish a public banking system to provide credit.

Require lenders to rent to foreclosed tenants.

Begin a long-term, forward-looking recovery plan.

Rebalance trade.