

Democratic Socialists of America

Greater Detroit Local



March 2009

The Only Road Out of the Financial Crisis: Nationalize the Insolvent Banks

The Obama administration's bank rescue plan fails to break with the logic of the prior Bush-Paulson plan: throwing taxpayer funds at de facto insolvent banks in order to put off their inevitable nationalization. Secretary of the Treasury Timothy Geithner's vague proposals call for another massive infusion of federal equity into "healthy" banks and a massive government insurance program to underwrite a "private market" for financial institutions' toxic assets. This plan is the same "lemon socialism"—the massive socialization of the losses of private financial institutions—that the Bush Administration put in place.

Major financial institutions, such as Bank of America and Citigroup, have already been de facto nationalized by the infusion of taxpayer equity whose value swamps that of these firms' aggregate stock market equity value. Rather than demanding equity shares in these banks and, thus, majority management control, the Obama administration plans to continue the

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NPC Resolution on the Bombing of Gaza and the Need for a Two-State Solution

Democratic Socialists of America deplores the Israeli bombardment and ground invasion of Gaza. These acts devastated the people of Gaza; and if indirect negotiations with Hamas had not been abandoned by Israel it is quite likely the cease-fire could have been maintained without the Israeli military escalation. By killing hundreds of Palestinian civilians, wounding thousands more, leaving upwards of 50,000 homeless and turning whole sections of Gaza City into what even Israeli observers call "an earthquake zone," Israel's three-week military operation was not only an excessive and inhumane response to Hamas's deplorable rocket launchings into Israeli population centers; It was a failure in that it did nothing to enhance the security of the Israeli people. In seven years of intermittent rocket launchings from Gaza, 22 Israelis have been killed and scores wounded. But these numbers, as horrid as they are, pale in comparison to the loss of civilian life among the Gazan population and the squalid conditions in which

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Bush administration’s policy of receiving only bond-like “warrants” in the banks rather than a direct ownership share. These insolvent “zombie banks,” as Princeton economist and New York Times columnist Paul Krugman calls them, are only “living” as private entities because of the endless infusion of government funds – funds that will inevitably fail to offset the declining value of the banks’ toxic assets.

The banks gladly take the government equity and use it to shore-up their deteriorating balance sheets rather than to engage in renewed lending. Healthier banks reward their managers and their stockholders (and bought up other smaller banks), while refusing to lend because they fear a further deterioration of the toxic assets on their balance sheets. Despite prior massive federal aid to financial institutions failing to unlock the frozen credit markets, the Obama plan proposes to waste a trillion dollars more in equity infusions and insurance guarantees in order to avoid de jure nationalization—even though such expenditure is unlikely to result in any new bank lending!

The new plan proposes that the federal government create a private market for the toxic assets where none exists now. Geithner knows that there is no private market for these worthless assets presently; hence why his plan is so vague. He is afraid to announce what is about to come – the government will spend hundreds of billions of taxpayer dollars to subsidize private purchasers of the assets (as private offerings on their own will not meet banks’ higher asking prices). Or the Federal Reserve and TARP will write “insurance” that would guarantee a high-floor price to private investors who buy the toxic assets. So the federal government will create a “free market” for the toxic assets by guaranteeing private investors against any sharp decline in the value of the assets they purchase. So much for the natural working of a capitalist market that rewards successful risk and penalizes failed risk!

But why are so many of our financial institutions de facto insolvent? Massive losses in the value of exotic financial instruments and other assets carried on balance sheets have left banks and shadow financial institutions, such as hedge funds and private mortgage lenders, owing their depositors more than they are presently worth. The claim that “high-risk” mortgage-backed securities could be securely bundled with “safe” ones depended upon esoteric econometric models that assumed that housing prices were very unlikely to fall in value. (These hare-brained speculative assets give new meaning to the adage that a model is only as good as its assumptions!) The financial institutions became overleveraged with these “collateralized debt obligations,” now transformed by the burst housing bubble into non-marketable, value-less assets. As the economy declined, fear of these securitized debt instruments spread to other forms of collateralized debt obligations, including bundled auto loans and credit card debt. As these bank assets declined in value, the banks drew back in their capacity and willingness to make new loans. Hence, the Geithner proposal also calls for a massive expansion of the Federal Reserve’s earlier proposal for a \$200 billion Asset-Backed Securities Loan Facility to a trillion dollar facility (aimed at creating a private market for student, credit-card and auto loans).

The only rational means to restore some long-term value to the toxic assets is to provide immediate federal relief to homeowners facing foreclosure and to homeowners struggling to pay mortgages for homes whose market value is today far less than the value of the mortgage. As in the Great Depression, relief will only come to the housing market, if the federal government creates a Home Loan Corporation that would have the power to renegotiate the terms of distressed

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mortgages – both by lowering the value of the mortgage (with the federal authority splitting the loss in equity with the banks and mortgage companies) and refinancing the adjusted loan at an affordable market rate. While the Obama plan calls for devoting \$50 billion to a “mortgage readjustment” program, the power and scope of the federal authority remains unspecified and the amount of capital is far below the \$200 billion that most economists believe would be necessary to calm the distressed home mortgage market.

Normally, the negative balance sheets of major financial institutions would lead the Federal Deposit Insurance Company to take them over in order to “unwind” their balance sheets of the valueless assets (whose deteriorating value precludes the banks from lending, as they do not have enough assets to securely meet their obligations to their depositors). Thus, as with the Savings and Loan crisis of the early 1980s (when toxic commercial mortgages choked off the home mortgage market), the FDIC should take over the insolvent banks and other financial institutions, seize their presently valueless assets and place them into a Resolution Trust Company, and then restructure the bank so that a healthier asset sheet would support renewed lending.

Once the sickly financial firm had regained its health, the FDIC could either re-sell it to private investors or the government could choose to run the bank itself. (There is no reason to believe that civil servants and publicly-hired managers could make any worse credit allocation decisions than did our vaunted private financial wizards!) When and if the housing market recovered, so would the value of the toxic assets. Then the Resolution Trust Company could sell the toxic assets to private investors without the expensive guarantees, with the proceeds repaying a portion of the large present infusion of government funds into the

banking system.

As the Swedish experience of the early 1990s proves (as does the disastrous Japanese delay in eventually nationalizing much of their insolvent financial sector in the late 1990s), the only way to work a financial system out of a disastrous period of speculative hyper-leveraging is to rework the banks’ balance sheets by a careful public process of “unwinding.” That is, rather than continually paying inflated prices for “toxic assets” that cannot be sold on a truly private market, the government should simply take those assets off the books of distressed financial institutions, so that their balance sheets can be restored to health.

Rather than re-selling all the restructured nationalized banks to private investors, the federal government should maintain full ownership of at least one major bank. Such a bank could serve as a benchmark institution, setting standards for investment in community housing, alternative energy development, and infrastructure that other private banks would have to match.

The disastrous experience of financial deregulation demonstrates that absent public regulatory restraint, finance capital will engage in irresponsible acts of speculative swindling during financial booms and resort to excessively conservative lending practices during financial busts. The deregulation of the financial industry has been a 30-year joint project of Republican monetarists and Democratic neo-liberals. This “free market” project began with the Carter administration’s deregulation of the Savings and Loans; accelerated under Reagan’s gutting of the entire government regulatory apparatus; and culminated in the Clinton administration’s abolition of the Glass-Steagall Act’s separation of commercial banks

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from investment firms (so that now the very banks that create risky financial instruments also market these instruments to their own clients!). After all, it was Lawrence Summers who convinced President Clinton not to allow the Commodity Futures Trading Corporation to create and regulate an open, transparent market for credit-default swaps (insurance against bond defaults). The unraveling of this unregulated, non-transparent \$60 trillion market still might bring the global financial system to total collapse.

Thus, if the federal government is to restore a sane credit system – a must for any productive economy – it should not only engage in the fiscally prudent step of nationalizing and restructuring insolvent financial institutions (the least costly path for the public treasury). The Obama administration must also recreate a vibrant and effective regulatory system for domestic financial institutions and cooperate with other states, both in the advanced industrial and developing world, to build a global financial regulatory system that prioritizes investment in productive enterprise over the speculative effort to make money on money.

The race-to-the-bottom of global neoliberal capitalism is the other half of the story behind our current economic crisis. Productive workers across the globe are no longer paid wages sufficient to purchase the aggregate goods and services they produce. The result: the Western working class went heavily into debt, particularly by borrowing massively against inflated home equity values, temporarily forestalling this impending global crisis of overproduction and under-consumption. In addition, the exploited working classes of China and Southeast Asia subsidized Western living standards, as their governments "managed" the market so as to run massive trade surpluses – with their governments investing this surplus not in domestic needs, but in buying United States

Treasury Bonds and private equity.

Thus, the restoration of a stable global economic system will necessitate raising the floor on global living standards and working conditions and creating global regulatory institutions that insure that investment and trade benefit the working people of the world. The era of deregulatory free-market mania is crashing down upon us. Only by reviving the capacity of democratic governments to regulate the economy so that it serves peoples' needs rather than the speculative desires of corporate elites will we recover from the current global economic nightmare.

~Joseph M. Schwartz

Member: DSA National Political Committee

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they must live within borders policed by Israel. The international community must of course consistently condemn unjust attacks on civilians by both sides. But as even conservative Prime Minister Ehud Olmert now admits, Israel can neither gain physical security nor perpetuate its status as majority Jewish state, unless it ends its unjust occupation of the Gaza Strip and West Bank.

Democratic Socialists of American urges the United States government and the international community to insure that the temporary ceasefire in Gaza leads to a sustained diplomatic effort to negotiate a just, two-state solution to the conflict between the Palestinian and Israeli peoples. The launching of rockets from Gaza targeting innocent Israeli civilians must be condemned by all who desire a peaceful solution to the Israeli-Palestinian conflict. But there can be no military solution, imposed by either side, to what is a political problem. Even if Israel were to re-occupy Gaza, this would in no way enhance the long-term security of the Israeli people.

DSA recognizes the right of the Israeli state to defend its people, but after more than 60 years of self-defense and 40 years of an unjust and illegal occupation of the West Bank and Gaza, it should be self-evident that peace and security for Israel cannot be achieved by in justice towards another people. The common Israeli/U.S. effort to isolate, both diplomatically and economically, the Hamas regime in Gaza only served to increase Gazan support for Hamas. The withdrawal of the Israeli Defense Forces from the West Bank and the creation of an economically viable and politically independent Palestinian state would provide the Palestinian people a reason to push aside rejectionist forces within their community. In the short-run, a viable cease-fire in Gaza must involve inter-

Workers' Victory Tour

On February 9th, hundreds of people, including many DSA members, gathered at the IBEW Local 58 Hall in Detroit to celebrate the victory won by the employees of Republic Windows & Doors in Chicago. The workers had been told without notice that their factory was closing and that they would not receive any sort of severance pay or any of the other benefits to which they were legally entitled. The workers responded by occupying the factory in a sit down strike and eventually forced the company to meet their demands after receiving support from around the country.

The night began with music from the Detroit Federation of Musicians, Local 5 as everyone enjoyed the food that was generously provided by the IWW Wobbly Kitchen. The sit down strikers from Chicago showed a video about their victory and took questions from the audience. They spoke about how they prepared for the occupation of the factory and how they all banded together to stand up for their rights. They then presented plaques to two veterans of the 1937 Flint Sit Down. The night ended with an energetic performance by Motown legend Martha Reeves, who had many folks dancing in the aisles. It seemed fitting that the Workers Victory Tour was at an IBEW hall since the mood that night was truly electric.

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national supervision of the crossing points between Egypt and Gaza and between Israel and Gaza. The basic needs of the people of Gaza cannot be met absent normal commerce between Gaza and Egypt, Israel and the West Bank. Re-opening the border crossings would also eliminate the Hamas rationale for abandoning the previously successful cease-fire. An internationally guaranteed cease-fire must also preclude the covert importation of arms into Gaza.

As the preponderant military force in the region, Israel can best reinitiate the peace process. Israel could help restore its tarnished international image by taking up the Arab League's 2002 initiative as a starting point for comprehensive peace negotiations. In 2002, the Arab League abandoned its long-standing denial of the right of the state of Israel to exist by offering to recognize the state of Israel in return for the creation of a Palestinian state on the West Bank and Gaza Strip, with its capitol in East Jerusalem.

DSA recognizes that its primary political responsibility is to change a United States foreign policy that continues to give a blank check to Israeli government policy by prolonging its policy of massive unconditional military aid to Israel. The Bush administration's unyielding support for Israeli intransigence has harmed the people of Gaza, the West Bank, and Israel itself. Thus, DSA will work, along with other pro-peace forces in the American Jewish, Arab, and broader progressive community to pressure the incoming Obama administration to adopt a balanced Middle-East approach. Such a policy should use carrots-and-sticks to encourage both sides in the conflict to make the hard choices and compromises that must be the foundation of an enduring peace. As activists in the Israeli peace movement have said for generations, the United States cannot contribute to the security of all the

Agenda for March 7th DSA General Membership Meeting

1. Treasury Report
2. Report on Jobs with Justice—U.S. Social Forum
3. Report on Michigan Universal Health Care Access Network (MichUHCAN)
4. Report on Michigan Alliance to Strengthen Social Security and Medicare
5. Report on Detroit Area Peace with Justice Network
6. Support for Michigan Coalition for Human Rights (MCHR) Annual Dinner
7. Report on Education Committee—next DSA Forum
8. Report on Renegotiate NAFTA Campaign
9. Op-Ed Campaign: What Socialists Really Think
10. Speaker: Deborah Olson on Public-Private Partnerships to Stimulate Employment in Areas of Chronic Unemployment
11. Speaker: State Representative Vickie Barnett—State Legislative Update

Calendar of Events

Thursday, March 5th	"Fighting Foreclosures," a Michigan Coalition for Human Rights program featuring speakers Vanessa Fluker and Jerry Goldberg at 7 PM at Barth Hall (corner of Woodward and Warren) in Detroit.
Saturday, March 7th	DSA general membership meeting from 10 AM until noon at the Royal Oak Senior/Community Center, 3500 Marais Avenue, Royal Oak
Tuesday, March 10th	Michigan Coalition for Human Rights film series—"Health for Sale" at 7 PM at St. John's Episcopal Church (11 Mile/Woodward) in Royal Oak
Tuesday, March 17th	Michigan Coalition for Human Rights film series—"Soldiers of Conscience" at 7 PM at St. John's Episcopal Church (11 Mile/Woodward) in Royal Oak Michigan Coalition for Human Rights film series—"Traces of the Trade: A Story of the Deep North" at 7 PM at St. John's Episcopal Church (11 Mile/Woodward) in Royal Oak
Tuesday, March 31st	Michigan Coalition for Human Rights film series—"Made in LA" at 7 PM at St. John's Episcopal Church (11 Mile/Woodward) in Royal Oak
Sunday, April 5th	DSA Executive Board meeting from 10 AM until noon at the home of Helen Samberg (30785 Hunters Drive, Apartment 23, Farmington Hills)
Sunday, April 19th	Michigan Coalition for Human Rights Annual Dinner at 5 PM at Fellowship Chapel (7707 W. Outer Drive) in Detroit - Keynote Speaker: Congresswoman Maxine Waters
Saturday, May 2nd	DSA general membership meeting from 10 AM until noon at the Royal Oak Senior/Community Center, 3500 Marais Avenue, Royal Oak
Friday, November 13th– Sunday, November 15th	DSA National Convention at the Best Western University Plaza in Evanston, Illinois adjacent to Northwestern University