

Economic Recovery for Everyone

A plan from Democratic Socialists of America

The Roots of the Crisis

The unregulated growth of a wildly speculative financial system – that is, a frantic attempt to *make money on money* rather than from productive investment – and the steady decline of the purchasing power of the global working class are the two main causes of the current near-depression. The global economic crisis stems, in part, from the classic case of underpaid workers overall not having the money to buy the very goods they make. To compensate for their loss of purchasing power, American working families turned to credit

cards and borrowed against inflated home equity values. Once the housing bubble burst, as all economic bubbles eventually do, the intricate financial world of collateral debt obligations and credit-default swaps came tumbling down, taking with it working families' ability to maintain their living standards.

Therefore, stricter government regulation of the financial industry must be central to any long-term economic recovery. The government must regulate the finance and banking industry so that it prioritizes providing credit on reasonable terms to productive enterprises. Precisely because the government now owns considerable equity stakes in our major financial institutions, it must demand a strong voice in their operations. Banks should cease paying bonuses to their disgraced managers and stop paying dividends to mostly wealthy stockholders. Instead, the government should re-

quire the banks to extend credit for responsible and productive economic purposes.

Raising the floor under people's wages, benefits, and working conditions is the other key step toward a long-term economic recovery; establishing universal health care and restoring an effective legal right to form unions cannot wait.

And in order for workers around the world to buy the goods they produce, the United States government needs to support measures that will raise global trade and labor standards. The de-unionization of the U.S. is part and parcel of a "race-to-the-bottom" economy and

policies that favored short-term speculative profits over long-term productivity in creating real goods and services.

The primary aims of the recovery plan must be:

- to put people back to work;
- to sustain the purchasing power of individuals and families and their access to health care, especially among those experiencing unemployment and underemployment;
- to invest in infrastructure, education, and alternative energy sources and thereby enhance the long-term productivity of the economy and work force; and
- to refinance distressed mortgages so that families can stay in their homes, neighborhoods can recover, and home values can stabilize. Such an effort would also improve the value of the "toxic assets" that the subprime mortgage crisis generated.

A Progressive Stimulus Package

The "economic recovery program" being debated in Congress must be large enough to revitalize consumer spending. Given that GDP declined by five percent in the fourth quarter of 2008, it is reasonable to expect that for some time to come the economy will operate at five percent or more below normal "full-employment" capacity. Thus, a stimulus program of roughly one trillion dollars per year, rather than the current Democratic House version of \$819 over two years, would be wise.

The president wishes to pass the "economic recovery package" by bi-partisan means. But trying to bring along

fiscally conservative members of Congress would simply mean the passage of a counter-productive bill. A stimulus package that is too small poses far greater danger than one that is too big. It would be like trying to roll a boulder up a hill with insufficient force. That is, its failure could throw the economy backwards, into accelerating deflation.

Moreover, Republicans would seize upon the failure of an inadequate recovery package to claim that fiscal stimulus does not work. Thus, the recovery package must be larger rather than smaller and should be weighted toward maintaining family purchasing power and health care coverage. It should not be weighted toward tax cuts. Their stimulus effect is doubtful, and they have a lower “multiplier effect” than does direct government spending. And, most certainly, the final package must not allow corporations to write off current losses against the past four years’ tax obligations. Such a corporate “tax rebate” would reward financial institutions for having taken irresponsible risks.

Conservatives enthusiastically supported the Reagan administration’s running budget deficits of over seven percent of the GDP in each of his first two fiscal years in office – that is, during the recession of 1981-82. The same proportion of today’s 14 trillion dollar economy would be approximately one trillion dollars. Rather than engaging in the Reagan program of tax

cuts for the rich and a massive expansion of defense spending, the present recovery package ought to shift investment from wasteful “defense” projects and enhance the industrial and technological productivity of the economy instead.

Government Can Rapidly Restore Demand

The most disabling myth promoted by both the Right and moderate Democrats is that government cannot efficiently spend large sums of money fast enough to generate real economic growth. But, as noted economist Robert Kuttner points out, the federal government could instantly engage in a trillion dollars of useful stimulus simply by writing checks (see box for a list of six things the federal government could do immediately).

If there is the political will, there is a way to immediately infuse our economy with a one trillion dollar increase in purchasing power – if these measures are implemented. And if the economy continues to stagnate in

2010, then extending the measures above for another six months would cost an additional \$500 billion dollars.

Restoring Working Families’ Purchasing Power

- provide \$200 billion in block grants to state and local government to make up for the annual loss in revenue that those governments will face in 2009. This would enable states and localities to maintain essential services and avoid lay-offs.
- allocate \$100 billion to pay for half of the increased costs in Medicaid that state governments will confront as more families of the unemployed apply for coverage.
- spend \$100 billion to pay for COBRA coverage for laid-off workers and to allow people over 55 who lose their jobs to buy into Medicare. This could be a transitional down payment on a universal health care program.
- use \$50 billion to increase unemployment insurance benefit levels and expand eligibility. (Currently only one-third of unemployed workers receive unemployment insurance!) In addition, unemployment benefits should supplement the income of part-time workers who cannot find full-time work.
- use \$100 billion to expand the number of Pell grant recipients and to increase the grants. This would enhance the skill base of the young and the unemployed and permit TANF recipients to attend college.
- move \$450 billion to the Social Security Trust Fund to give workers a one-year holiday from the regressive FICA tax. This tax cut would disproportionately benefit middle- and working-class families, as more than half of American taxpayers pay more in payroll taxes than they do in income tax. The government should make up the loss to the Trust Fund, contingent on employers not cutting wages. This would radically stimulate consumer demand.

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Restoring Long-Term Investments in Housing, Infrastructure, and Alternative Energy

The second part of a stimulus package should include longer-term investments that would restructure the American economy so that it depends less on an over-expanded financial sector and more on production of goods and services that benefit ordinary people. (The financial sector employs 12 percent of the workforce but generated 30 percent of profits in the first eight years of the 21st century.)

Congress should immediately create a modern version of FDR's Home Owners Loan Corporation. This public entity should engage in direct federal lending to refinance distressed mortgages and, where necessary, reduce the outstanding principal amount.

The initial cost might be about \$200 billion, but most of the additional debt would eventually be repaid by homeowners paying off newly affordable mortgages. Roosevelt's Home Owners Loan Corporation ended up yielding a modest profit for the Treasury. Such a measure today could keep three million at-risk homeowners in their homes. By putting a floor under home prices, the pension funds and other institutional investors who bought toxic mortgage-backed securities would at least realize something on their investment – many of which now have a market value of zero.

To enhance the long-term competitiveness and efficiency of the economy, as well as generate millions of high-wage jobs, the federal government should invest in a broad range of infrastructure programs. These would include traditional outlays on roads, bridges, and mass transit as well as 21st century infrastructure projects such as retrofitting homes, installing universal broadband, and creating a smart-grid electricity system. Major public investments should be made in green technologies and green jobs, and job-training could especially target historically underemployed communities. While this program would cost \$300 billion, the benefit in long-run growth would be incalculable.

Restoring Long-Term Fiscal Health

Even conservative economists such as Martin Feldstein, who headed the Council of Economic Advisers under Reagan, admit that massive deficit spending is necessary to stimulate a seriously depressed economy. Appropriate defi-

cit spending now will yield greater government tax revenues in the long run than would an inadequate stimulus that fails to stop the economy's downward spiral. But Republicans and moderate Democrats will call for a "restoration of fiscal discipline" and "balanced budgets" at the first sign of economic recovery. What many of these "budget hawks" do not realize is that even in prosperous times, the federal government should engage in long-term investments in infrastructure and research and development.

Restoring a moderately progressive tax system in the

United States and cutting exotic and outlandish defense programs would readily provide sufficient revenues to fund a vibrant and efficient public sector. Reversing the Bush tax cuts for the rich would restore \$300 billion in

annual tax revenues. Doing the same to the Reagan tax cuts would garner another \$500 billion in annual federal taxes. And abolishing the 15 percent tax rate cap on hedge fund and private equity managers' earnings would yield another \$100 billion in annual revenues. Truly ending the war in Iraq should save \$100 billion per year; a modest one-third cutback in United States military bases abroad and an end to outmoded Cold War era plans to build a next generation of fighters and anti-ballistic missile defense could save \$216 billion in federal revenues per year. The money is there for a responsible and progressive budget policy if the political will can be built.

Real Prosperity Requires Restoring Regulation and Building Global Social Democracy

Many of the Clinton re-treads on the Obama economic team supported the deregulation of exotic financial instruments such as credit-default swaps. Therefore, strong popular pressure from below will be needed to achieve the re-regulation of the finance industry. The deregulation of the savings and loan industry that began under Jimmy Carter destroyed a New Deal institution that provided reasonable credit for the sole purpose of families purchasing homes. The destruction of the Glass-Steagall Act's separation between commercial banking and finance banking – which culminated under the Clinton administration – led to "super banks" having the incentive to market to individual and institutional investors the very financial instruments they

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underwrote, regardless of the risk of these instruments. The wide “neo-liberal” consensus that celebrated the death of Keynesian economics forgot Keynes’ warning that an unregulated financial sector would give rise to a speculation-driven capitalism that would destroy the productive economy.

It is now time for the government to take control of these bankrupt banks.

The federal government already has *de facto* nationalized many major financial institutions by pumping in public equity to prevent them from going bankrupt. It is now time for the government to take control of these bankrupt banks and restore them to financial health and prudent lending of capital for productive purposes. Countless banks are already insolvent; their assets have less market value than their liabilities. The government’s continual infusions of equity into these banks only serves to reward the management that took wild speculative risks, and this socialization of loss only provides private bankers with incentives to take such risks again. If the government is to provide further equity to any banks, it should receive, in return, regular stock, which would give the government voting rights in the management of the bank.

But repeatedly pumping equity into “ghost banks” that are insolvent does not tackle the “toxic asset” crisis and unceasing foreclosures that are the root cause of the banking crisis. Thus, Paul Krugman correctly argues that the federal government should nationalize these insolvent banks and clean out their shareholders. The government should then transfer these banks’ “toxic assets” to a special institution, a Resolution Trust Corporation; pay off enough of the nationalized banks’ debts to make them solvent; and sell the fixed-up banks to new owners. This would avoid the government paying an inflated value for the “toxic assets” that are dragging down the asset value of the banks. (As these assets decrease, the government has to pump in more equity in order to maintain the fiction that these private banks are solvent.) It would also enable taxpayers to recoup some of the TARP funds when and if the government sells to private investors those “toxic assets” that recover when the housing market stabilizes.

In addition to democratic regulation of the finance industry, raising the floor under workers’ wages, benefits, and working conditions must be part of a long-term economic recovery program. Universal health care and restoring an effective right to form unions cannot wait. They are integral to restoring a competitive and equitable U.S. economy.

The current crisis of the Big Three automakers partly results from past mismanagement. But, contrary to conservative propaganda, the crisis of the Big Three does not come from excessively high union wages; the UAW wage premium over domestic foreign-owned manufacturers is only four dollars per hour. Rather, the crisis of profitability in

the Big Three stems from those corporations having to provide supplemental health care coverage and pensions for several hundred thousand retired workers (the foreign transplants do not offer good benefits to retirees, and few workers have retired at these relatively new plants). Thus, a single-payer universal health care system, which would radically cut the administrative costs of health care, would not only provide health care to all, but it would also make major United States manufacturers more competitive.

The de-unionization of the U.S. economy is part and parcel of a “race-to-the-bottom” economic strategy and policies that prioritized short-term speculative profits over long-term productivity of real goods and services. Thus, the restoration of the democratic right to form free trade unions in the United States – and the extension of that right around the globe, through fair trade and labor rights accords with teeth – should play a central role in a new “global New Deal.” For if United States workers must compete with repressed workers abroad, then U.S. workers’ living standards will inevitably fall to the level of their competitors.

A successful economic recovery requires restructuring the U.S. economy so that it prioritizes the well-being of working people and the planet over finance capital’s short-term drive for profit. Anything short of a democratic reorientation of U.S. capitalism fails to address the root causes of the greatest global economic crisis since the Great Depression.

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