# DOLLARS & SENSE

REAL WORLD ECONOMICS

November | December 2010




# Underwater

## Profits and pay are sky-high, even as bad loans are sinking the megabanks.

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DOLLARS & SENSE
REAL WORLD ECONOMICS

*Dollars & Sense* magazine explains the workings of the U.S. and international economies and provides left perspectives on current economic affairs. It is edited and produced by a collective of economists, journalists, and activists who are committed to social justice and economic democracy.



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## From the Editors

# Fury, Fraud, and Foreclosures

Patchwork Nation, a reporting project launched two years ago by the *Christian Science Monitor*, seeks to make sense of U.S. electoral politics by looking at demographic trends. The project's researchers recently reported finding that the congressional districts with the most Tea Party "meetups" over the last four months also had the highest rates of foreclosure. "There are 38 foreclosures [since January] for every 1,000 homes in those places. And remember, those figures are just the beginning. They equal lost home values that prevent moving for some, and lost nest eggs that mean delayed retirement for others." The conclusion? Much of the anger in the electorate "is driven by foreclosures."

That's understandable—although why exactly that anger would drive anyone toward the Tea Party is another question. The Tea Party candidates in this year's midterm elections advocated policies like tax cuts and deregulation that, as John Miller points out in this issue (p. 12), are only likely to deepen the economic distress.

On the other hand, there is surely something to the Tea Partiers' anti-government fervor—or at any rate to the broad disappointment with the federal government's response to the Great Recession. Consider Nicolle Bradbury, whose case the *New York Times* has depicted as setting off the recent furor over foreclosure fraud. In 2003, Bradbury bought a modest home in the rural town of Denmark, Maine, for $75,000. Three years into her mortgage, she lost her job and soon could no longer afford her payments of $474 a month.

The mortgage was owned by Fannie Mae (which has since been nationalized) and serviced by GMAC (which is now 90% owned by the government as a result of the bailout). The companies have since spent several years—and more money than the house is worth—trying to foreclose on Bradbury. But in the final hour, Bradbury got some volunteer help from a retired lawyer named Thomas A. Cox, who noticed irregularities in the paperwork. Cox had stumbled on the "robo-signing" and fabrication of documents that are central to what is now being called "Foreclosuregate."

Who wouldn't be angry about the government's priorities? Here's a woman who lost her job (as an employment counselor, no less!), and the government—in the form of Fannie Mae and GMAC—responds not by offering her job training or a public works program in her town, but by using fraudulent means to evict her and her kids from their home. Bradbury herself makes the best case for government help: "A lot of people say we just want a free ride. That's not it. I've worked since I was 14. I'm not lazy. I'm just trying to keep us together. If we lost the house, my family would have to break up."

Why shouldn't we expect a coordinated and humane response to the foreclosure and job crises, led by the federal government? And shouldn't the government be forcing the banks it bailed out to change their ways? Instead, as Rob Larson's cover story (p. 13) shows, profits and executive compensation are soaring while bad loans may well be sinking the big banks. The federal government appears to wish that the emerging foreclosure scandal would go away just as much as the big banks do. The banks' brief foreclosure freeze was self-imposed, not mandated by Washington, and state attorneys general are taking the lead in investigating the scandal.

We've seen this before. At the height of the subprime lending spree, it was the states that were sounding the alarm and trying to regulate predatory lending. The federal government actually stood in the way, as Jim Campen points out in his comment on mortgage lending discrimination (p. 6): "[T]he Comptroller of the Currency, the principal regulator of the nation's largest banks, actually went to court to stop New York's attorney general from enforcing that state's anti-discrimination laws against big national banks." As Joe Nocera pointed out recently in the *New York Times*, it is a good thing that the states are taking the lead in investigating Foreclosuregate—something might actually get done about it this time. D&S

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## FEATURES



## THE REGULARS

*By Amy Gluckman and Chris Sturr*

## D'Banks on D'Junkets?

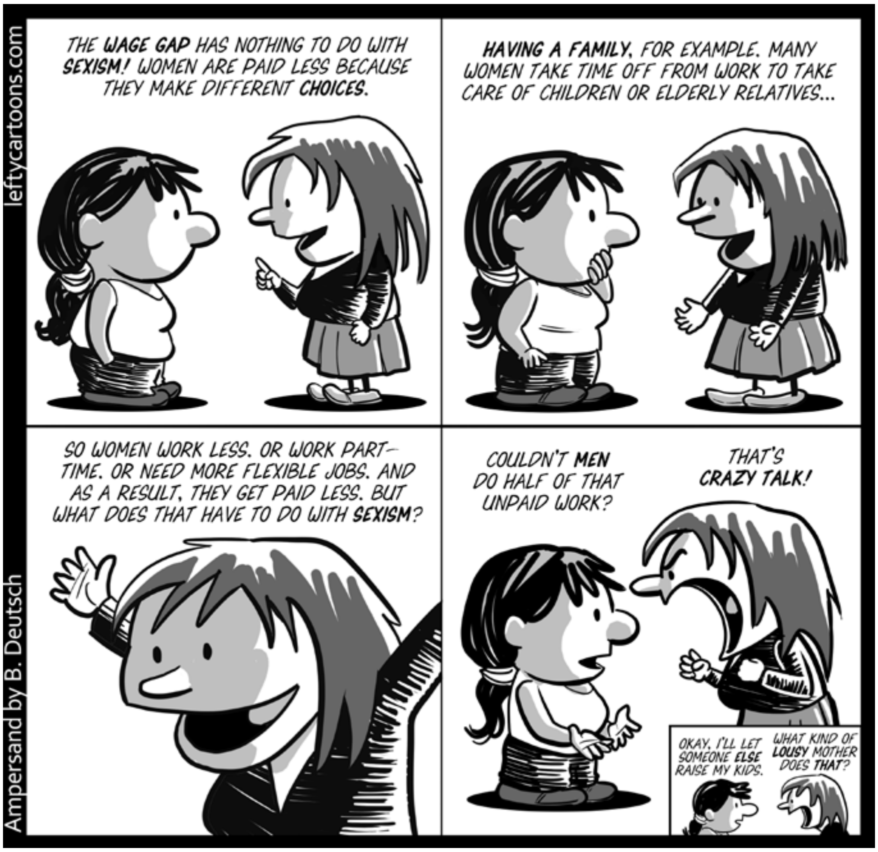
Here's how to get your bosses to pay for a **Disney World** vacation for you and your co-workers. Just convince them your company needs to D'Think its business. No, we did not make that up. "D'Think is the unique Disney Institute approach to professional development and corporate problem-solving, built on the real-life business practices of The **Walt Disney Company**," touts a recent ad from the institute, the business consulting arm of the Disney empire.

If you "immerse yourself in a multi-day program at a Disney Destination," the institute's promotional materials say, "you will find your organization has more in common with Disney than you ever imagined." Perhaps the big banks attended Disney Institute programs: that might explain the magical thinking they appeared to engage in in the years leading up to the financial crisis. —AG

## A Reason Not to Eat Out

In a nationwide survey of over 4,300 food workers conducted by **Restaurant Opportunities Centers United**, over 63% reported preparing, cooking, and serving food at work while sick. That should be no surprise, given that fewer than 13% of the workers surveyed had paid sick leave. With a national median wage of $8.59 an hour, restaurant workers can hardly afford to stay home, sick or not. They couldn't go to the doctor anyway: 90% lack health insurance.

Restaurant Opportunities Centers United brings together the restaurant worker organizing groups that have sprung up in cities around the country over the past decade. The first was ROC-NY, organized after 9/11 to support the workers from **Windows on the World** (the restaurant on the top floor of one of the World Trade Center towers). —AG




## Americans ❤ Sweden

A pop quiz about wealth, defined as "all property of value, from cash to art to stocks and bonds to homes, minus debts":

(1) What percentage of U.S. wealth is owned by the bottom 40% of the population?

(2) What percentage *should* the bottom 40% own, in an ideal version of U.S. society?

(3) What percentage is owned by the top 20%?

(4) What percentage *should* the top 20% own?

Given the bitter partisan divide in this country, especially over issues related to taxation and redistribution, you might think that Americans would give sharply different answers to these questions based on political affiliation and income.

In fact, as **David Cay Johnston** points out in a recent issue of the newsletter ***Tax Notes***, a recent survey by behavioral scientists Daniel Ariely and Michael Norton shows that "Americans think very much alike on wealth distribution."

Almost everyone surveyed hugely underestimated the degree of wealth inequality in the United States. (Academic economists did somewhat better, but still estimated that the bottom 40% had *seven times* their actual wealth.) But the vast majority got it right—or rather, *left*—about what the ideal distribution would be. Ninety-two percent of respondents—including *90.2% of people who voted for Bush in 2004*—picked a pie chart representing the actual wealth distribution of **a certain Nordic social democracy** over one representing the actual wealth distribution of the United States.

Try the quiz yourself—see below for the answers. —*CS* D&S

(1) Respondents' estimate: 10%; actual: 0.3%.
(2) Respondents' ideal: 20-25%.
(3) Respondents' estimate: 60%; actual: 85%.
(4) Respondents' ideal: 36%.

## Letters to the editors

# *Biased* Outlook

*A D&S subscriber cc'd us on the following letter to David Wyss, chief economist of Standard & Poor's, the financial services company best known for the S&P 500 stock index. Wyss had written an article in S&P's newsletter,* The Outlook.

To **David Wyss**, Chief Economist, S&P:

Your bylined article, "**Washington Worries**," in *The Outlook* dated October 13, 2010, though a mere 245 words, claims a panoply of dire results—double-dip recession, triple-digit oil prices, worse-than-expected housing prices, further weakness in consumer and investor confidence, a recession lasting until late 2011, stocks falling below their March 2010 low, a deeper downturn in Europe and Japan, the deepest recession in postwar history, and double-digit unemployment through 2013—all resulting from "the expiration of the Bush tax cuts."

According to the nonpartisan Tax Policy Center, making all of the Bush tax cuts permanent would cost the federal government $680 billion in revenue over the next ten years, **nearly all of it going to the richest 1% of Americans and more than half to the richest one-tenth of 1%**. Since these recipients are unlikely to spend much, if any, of such a windfall, it cannot be regarded as a way to stimulate the economy significantly.

Your assertion and the accompanying table appear to have been published not to provide your readers with investment advice but to convince them to vote Republican in elections to be held less than three weeks from your publication date. They are consistent with the current campaign of disinformation from the right, based on thoroughly discredited "trickle down" economic nonsense, fact-free assertions, and cooked numbers.

I am disheartened that *The Outlook* has degenerated into a vehicle for such demagoguery.

**Bradley Hitchings**
Rye, N.Y.

# *Voting Frustration*

*Another subscriber,* ***Miguel Sanchez*** *of Los Angeles, Calif., sent us a short message via email on election day: "****The electronic ballot box rejected my vote.****" The email included the image below as an attachment.*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# Update on Mortgage Lending Discrimination

*After a disastrous detour, we're back where we started.*

BY JIM CAMPEN

In the 1980s and early 1990s, racial discrimination in mortgage lending resulted in less access to home loans for predominantly black and Latino borrowers and neighborhoods. Home mortgages were a fairly standardized product, and the problem was that banks avoided lending in minority neighborhoods (redlining) and denied applications from blacks and Latinos at disproportionately high rates compared to equally creditworthy white applicants (lending discrimination).

Soon afterwards, however, a different form of lending discrimination rose to prominence as high-cost subprime loans became increasingly common. Precisely because borrowers and neighborhoods of color had limited access to the traditional prime loans, they were vulnerable for exploitation by predatory lenders pushing the new product.

Redlining was soon over-shadowed by "reverse redlining." Instead of being ignored, borrowers and neighborhoods of color were now aggressively targeted for high-cost subprime loans. Community groups documented and aggressively publicized the problem, and the U.S. Department of Housing and Urban Development (HUD) reported in 2000 that "subprime loans are five times more likely in black neighborhoods than in white neighborhoods." By the final year of the Clinton administration, government regulators were mobilizing to take action against this plague. But once the Bush administration took over in 2001, predatory lenders had nothing to fear from the federal government.

In the early 2000s, predatory lending began to take on a new and more explosive form. Mortgage brokers earned high fees for persuading borrowers to take on high-cost loans from lenders, who then sold the loans to big Wall Street firms, who in turn packaged them into "mortgage-backed securities" that were sold to investors. Everybody earned big fees along the way—in fact, the worse the deal was for borrowers, the bigger the fees for everyone else—and so the system gathered incredible momentum. Wall Street's demand for loan volume led ultimately to a complete lack of lending standards and millions upon millions of loans were made to borrowers who had no realistic prospect of repaying them.

**Housing activists protest discriminatory foreclosures in front of the U.S. Capitol in March 2009. Photo credit: PICO National Network.**

For present purposes, the most important aspect of this appalling story is that these exploitative high-cost loans were strongly targeted to borrowers and neighborhoods of color. My own research on lending in Greater Boston during 2006, the peak year of the subprime lending boom, found that 49% of all home-purchase loans to blacks, and 48% of all home-purchase loans to Latinos, were high-cost loans, compared to just 11% of all loans to whites—and that the share of high-cost loans in predominantly minority neighborhoods was 4.4 times greater than it was in predominantly white neighborhoods. Similar racial and ethnic disparities were documented in numerous studies all across the country. Echoing work by researchers at the Federal Reserve Bank of Boston fifteen years earlier, the Center for Responsible Lending made use of industry data to demonstrate that these disparities could be only partially accounted for by differences in credit scores and other legitimate measures of borrower risk. In other words, they again provided statistical proof that racial discrimination was at least partly responsible for the observed racial disparities.

Nevertheless, federal regulators again did virtually nothing in response to the abundant evidence of violations of fair housing laws. Their most vigorous action was when the Comptroller of the Currency, the principal regulator of the nation's largest banks, actually went to court to stop New York's attorney general from enforcing that state's anti-discrimination laws against big national banks.

Finally, in 2007, the housing bubble popped and subprime lenders collapsed. Millions of homeowners who had received high-cost subprime loans either lost their homes to foreclosure or are in danger of being foreclosed upon soon. Because they were targeted by the predatory lenders, blacks and Latinos have been hit the hardest by this foreclosure tsunami. For example, researchers at the Center for Responsible Lending estimated that among recent mortgage borrowers, "nearly 8% of both African Americans and Latinos have lost their homes to foreclosures, compared to just 4.5% of whites."

By 2008, borrowers and neighborhoods of color were no longer being targeted by predatory lenders, as that industry had all but disappeared in the aftermath of the subprime meltdown. Instead, the more traditional form of discrimination again rose to the foreground. A recent report by a group of community-based organizations from seven cities across the country found that between 2006 and 2008 prime mortgage lending decreased 60.3% in predominantly minority neighborhoods while falling less than half that much (28.4%) in predominantly white neighborhoods. Home Mortgage Disclosure Act data for 2009, as tabulated by the Federal Reserve, showed that the denial rate for black applicants for conventional mortgage loans was 2.48 times greater than the denial rate for their white counterparts (45.7% vs. 18.4%; the denial rate for Latinos was 35.9%). This denial rate disparity ratio is actually greater than those that created widespread outrage when denial rate data first became public in the early 1990s.

Geoff Smith, senior vice president of Chicago's Woodstock Institute, summed up the new situation this way: "After inflicting harm on neighborhoods of color through years of problematic subprime loans, banks are now pulling back at a time when these communities are most in need of responsible loans and investment. We are concerned that we have gone from a period of reverse redlining to a period of re-redlining." **D&S**

*JIM CAMPEN, a founder of* Dollars & Sense, *is a professor emeritus of economics at University of Massachusetts-Boston and former executive director of Americans for Fairness in Lending.*

**SOURCES:** U.S. Dept. of Housing and Urban Development, "Unequal Burden: Income & Racial Disparities in Subprime Lending in America," 2000 (archives.hud.gov/reports/subprime/subprime.cfm); Jim Campen, "Changing Patterns XIV: Mortgage Lending to Traditionally Underserved Borrowers & Neighborhoods in Boston, Greater Boston, and Massachusetts, 2006," Massachusetts Community and Banking Council (www.mcbc.info/files/ChangingPatternsXIV_0.pdf); Center for Responsible Lending, "Unfair Lending: the Effect of Race and Ethnicity on the Price of Subprime Mortgages," 2006, and "Foreclosures by Race and Ethnicity: The Demographics of a Crisis," 2010 (both available at www.responsiblelending.org); California Reinvestment Coalition and six other groups, "Paying More for the American Dream IV: The Decline of Prime Mortgage Lending in Communities of Color," 2010 ( available at: www.woodstockinst.org).

# The Case for a National Infrastructure Bank

## A bank could be a recession-proof source of jobs.

BY HEIDI GARRETT-PELTIER

Tragic events in recent years, such as the Minnesota bridge collapse or New Orleans' failed levees, combined with the daily aggravations of pot holes and power failures, underscore the need for improved infrastructure across the United States. The American Society of Civil Engineers gave the United States a "D" on its most recent *Report Card for America's Infrastructure*; the organization estimates that it will cost $2.2 trillion over the next five years to bring our infrastructure up to "good" condition.

Besides helping prevent disasters, infrastructure improvements create jobs. Maintenance, repair, and new construction of roads, buildings, water, and energy systems create jobs for engineers, construction crews, machinery manufacturers, and bookkeepers, among others.

Infrastructure improvements also have so-called positive externalities: their social benefits are greater than the financial gains earned by the parties who fund them. Improving roads, bridges, and transit systems can increase productivity, lower the cost of maintaining cars and buses, and reduce carbon emissions. Energy investments can increase productivity, and if directed toward energy efficiency and renewables, can also promote environmental sustainability. Investments in water systems lead to better health and lower health care costs.

Private companies cannot reap financial rewards from all of these indirect benefits. For instance, a private rail company could not feasibly charge a fee to everyone who enjoys less-congested roads or cleaner air thanks to a new rail line. So infrastructure projects have traditionally been publicly funded, primarily at the local level with some state and federal assistance.

Public infrastructure funding often falls short, however. In a recession, state and local tax revenues fall, making it harder to fund infrastructure projects precisely at a time when they could help the economy recover. Another problem is that during downturns and recoveries alike, higher-income localities are better able to fund their own roads or water systems than poorer ones. So available funds do not necessarily go to the projects providing the greatest benefits.

**Today the United States invests in infrastructure at only half the level the American Society of Civil Engineers recommends.**

Today the United States invests in infrastructure at only half the level the ASCE recommends. One proposal for an innovative method to finance infrastructure is currently garnering bipartisan interest—a national infrastructure bank (NIB). An NIB would be a quasi-public agency whose function would be to use some federal funds to leverage a much larger amount of state, local, and private money which it would then provide to infrastructure projects.

An NIB could use various tools to finance infrastructure. It could sell bonds to private investors. It could be set up as a revolving loan fund, whereby an initial pool of funds is lent, and future loans made only once the earlier ones are repaid. It could even make grants for certain projects.

There are merits and drawbacks to any of these financing models. Some would make the NIB entirely self-sustaining, and so compel it to prioritize projects with a revenue stream, for instance from tolls, that would go to paying back the loan. Such a model would limit the bank's ability to choose projects with greater social benefits but less ability to repay funds quickly: it might fund construction of a toll road to a wealthy suburb rather than an upgrade to a municipal water system despite the latter's greater benefit. Other models would require more federal spending, but would give the bank greater flexibility to fund projects with less revenue potential.

In any case, a national infrastructure bank would make an important contribution to upgrading and expanding the country's infrastructure. It would boost the overall level of infrastructure spending. By leveraging private investment, it could continue to fund infrastructure projects even during recessions. Plus, it would make infrastructure spending more equitable since it would raise funds from a geographically distributed population, then target those funds toward the areas of greatest need. D&S

*HEIDI GARRETT-PELTIER is a research fellow at the Political Economy Research Institute at the University of Massachusetts, Amherst.*

# Deficits: Real Issue, Phony Debates

## What's at stake on either side of the class divide.

BY RICK WOLFF

Deficits have now risen, yet again, to headline status. Conservatives inside and to the right of the Republican Party frame the national debates by attacking deficits. They want to reduce them by cutting government spending. Liberals respond, as usual, by insisting that overcoming the crisis requires big government spending ("stimulus") and hence big deficits. Most Americans watch the politicians' conflicts with mixtures of confusion, disinterest, and disdain. Yet deficits pose a real issue for everyone, one that the debates among politicians and their economist advisors miss, ignore, or hide.

When the federal government raises less in taxes and other revenues than it spends, it must borrow the difference. Such annual borrowing is each year's deficit. The U.S. Treasury borrows that money by selling bonds, federal IOUs, to the lenders. The accumulation of annual deficits comprises the national debt, the total of outstanding U.S. treasury bonds. So the first and simplest questions about deficits are (1) why does the federal government choose to borrow rather than to raise taxes? and (2) why does it borrow rather than cut its expenditures? The twin answers are profoundly political. Elected officials are afraid to raise taxes on business and the rich because their profits and great personal wealth can then finance the defeat of officials who do that. Cutting government spending that benefits business and the rich is avoided for the same reason. As the tax burden shifted increasingly onto middle- and lower-income people in recent decades, elected officials have faced rising tax revolts coupled with demands for more government services and supports.

In the United States—as in most capitalist countries—business and the rich, on one side, and the middle-income and the poor on the other, have placed the same demands on the government budget. Each side has wanted *more* government spending on what it needs and *less* taxes on its incomes. Both political parties thus fear raising taxes or cutting spending on the masses because that risks electoral defeats. This has been a very real, basic, and socially disruptive contradiction built into capitalist systems.


The "National Debt Clock" in New York City, March 2010.

These days, business and the rich want *both* massive government supports to overcome the current crisis *as well as* their usual government benefits. The latter include government activities abroad—including wars—that secure export markets and access to crucial imports (e.g., the needed quantities and prices of business inputs and consumer goods not domestically available). They also demand the particular subsidies typically provided to agricultural enterprises, transport companies, defense producers, and so on, as well as tax reductions offered for various kinds of investments. Businesses press government to maintain or expand roads, harbors, airports, schools, mass transportation systems, and research institutes crucial for their enterprises' profits. Wealthy individuals want government spending on the police and judicial systems that protect their wealth.

Business and the rich likewise want the government not to raise their taxes. Businesses seek to keep in place their legal opportunities to evade taxes on profits (by means of offshore operations, internal transfer invoicing, etc.). Business and the rich in the United States want donations to their own foundations, to rich universities, art institutions, and their favorite charities to remain subsidized by generous federal tax deductions granted for such donations. They also currently demand the continuation of Bush-era tax exemptions and reductions on taxes on their incomes and on the estates they leave.

Middle-income and poorer Americans demand government spending for their unemployment insurance, as well as spending to prevent or soften the blow of home foreclosures, to provide low-interest mortgage money for their home purchases or refinancing, and to guarantee low-interest educational loans for their children. They want public schools well financed to function as means of advancement

**That business and the rich prefer lending to finance government deficits over being taxed instead is just their understandable self-interest.**


for their children. They support government regulation to guarantee safe and honestly labeled consumer goods and services and likewise health and safety on their jobs. They demand Social Security retirement benefits and Medicare. They share support for Medicaid, food stamps, and welfare, despite some demonization of those programs and their recipients. And they oppose both more taxes and higher government deductions from their incomes for these programs.

In all capitalist countries, more or less, the contradiction between these conflicting financial demands on the government's budget has shaped politics. Thus, elected officials have neither raised taxes nor cut spending enough to bring them into balance. Instead they have increasingly resorted to borrowing—running budget deficits. The officials like deficits because they reap immediate political benefits—"satisfying" business, the rich, and all the rest by holding down taxes and maintaining spending—while shifting the political costs of repaying rising national debt and its rising interest costs onto office-holders coming after them (today's equivalent of Louis XV's remark, "*après moi le deluge*").

Government borrowing also benefits businesses and the rich by offering them an attractive investment. They lend money to the government that then repays those sums with interest. Instead of losing a portion of their wealth by paying taxes, those groups keep that portion (in the form of a purchased government bond) and earn more with it. Businesses and the rich are usually major lenders to their governments; workers rarely are. The same U.S. business leaders who advise governments to "live within their means" simultaneously fill their business and personal portfolios with government bonds.

Each country's unique history, culture, and politics determine how much its government borrows. In the United States, as elsewhere, successive governments (usually of both left and right) have borrowed so much that further borrowing is becoming increasingly difficult. One obstacle looms, because the more a government pays in interest and debt repayment, the less funds it has to undertake the spending business and the public demand. Over the last five years, annual interest payments on the U.S. national debt have averaged over $400 billion. Political opposition to continuing those interest payments, and perhaps anger directed against lenders, may arise (as has already happened in Europe). Since lenders to governments are overwhelmingly businesses, rich individuals, and various government entities (foreign and domestic), such opposition may draw on deep resentments. Rising national indebtedness therefore builds its own opposition. Where and when that happens or even threatens to happen, major lenders stop risking further purchases of government bonds. Unable to borrow as before, governments return to face the original problem: which social groups are going to be taxed more and/or which will suffer government spending cuts.

Greece, Ireland, Hungary, and Spain are among countries whose people have already felt the impacts of their combinations of tax increases and spending cuts. In those countries, businesses and rich citizens have been able to impose their preferred response to the problem of deficits, what politicians call "austerity." When government borrowing must be reduced or stopped, "austerity" means sharply cut government spending on public sector jobs and services for the mass of people. Across Europe, government after government is being pressed by its businesses and its richest citizens to impose austerity on its people. However, also across Europe, slowly but steadily—because they are less well organized and financed—labor unions, left parties, and left political formations are mobilizing against austerity and for alternative plans. These involve raising taxes on business and the rich and/or reducing the government spending benefiting them.

Because the United States is the world's richest country and can borrow more and more easily than other countries, the federal government has not yet reached the limits of its borrowing capacity. However, states and municipalities are forbidden to borrow for their operating budgets, so they have already imposed austerities across the United States (especially visible in the massive spending cuts on public services in California and New York). Yet in the United States, too, there are the beginnings of signs of an anti-austerity movement. For example, in January 2010, Oregon voters ratified their state's decision to respond to the economic crisis neither by borrowing nor by cutting state expenditures, but rather by raising over $700 million in taxes on businesses and on households earning over $250,000 per year.

Consider this example of this kind of alternative to austerity programs: Every year, two companies catering to rich investors survey their clients. Capgemini and Merrill Lynch Wealth Management's "World Wealth Report for 2010" counts as High Net Worth Individuals (HNWIs) everyone with at least $1 million of "investible assets" *in addition to* the values of their primary residence, art works, collectibles, etc. HNWIs in the United States numbered 2.9 million in 2009: well *under 1% of the people in the United States*. The HNWIs' investible assets totaled $12.09 trillion. For 2009, the total U.S. budgetary deficit was $1.7 trillion. Had the U.S. government levied an economic emergency tax of 15% on only the HNWIs' investible assets, no government borrowing would have been necessary in 2009. Obama's stimulus program would have required no deficit, no borrowing, and no additional taxes for 99% of U.S. citizens.

The real debates all along should have been—and now ought to be—about *who* pays how much in taxes and *who* benefits in what ways from government spending. Deficits are necessary neither in normal economic times nor when crises hit and government stimulus is required. That business and the rich prefer lending to finance government deficits over being taxed instead is just their understandable self-interest. The rest of us have not only the right to a very different preference, but also a clear basis in economic theory and available empirical studies not to abandon our preference for theirs. We only have deficits because of who pays and who does not pay how much in taxes and who gets how much in government spending.

We should be debating the social acceptability of a capitalist class division between employers and employees that places dangerously contradictory pressures on government budgets. Had we had such debates and a democratic process of deciding them in the United States, deficits and their consequences might have been avoided. But that never happened. Instead, the mainstream debates about deficits have simply assumed their necessity. Those debates then focus narrowly on the size of deficits—whether larger versus smaller is better—rather than on why they exist and who benefits from them. No wonder those debates have never solved the deficit problem; they functioned rather to obscure the underlying issue about who pays for and who benefits from government budgets in capitalist societies. **D&S**

*RICK WOLFF teaches economics at the University of Massachusetts-Amherst and is author of* Capitalism Hits the Fan: The Global Economic Meltdown and What to Do About It.

# That Hurt! Let's Do It Again.

BY JOHN MILLER

**A Tale of Two Recoveries**

It's official: The Great Recession ended 15 months ago, in June 2009. … [T]he downturn that began in December 2007 lasted 18 months … only two months longer than the 16-month downturns of 1973-75 and 1981-82 … .

What is different about this period is the relative weakness of the economic recovery. … [I]n 1983 the recovery surpassed its previous peak in gross domestic product very rapidly from the recession's trough. …

This time, even after a year of recovery through June 2010, real GDP remained 1.3% below its previous peak …

Consider this contrast: In 1983, the Reagan cuts in marginal tax rates were finally kicking in, regulatory burdens were falling across the economy, and the Federal Reserve was cutting interest rates. In 2010, taxes are heading up, new regulations are piling up thanks to ObamaCare, et al., and the Fed can't keep interest rates near-zero forever. We think these different policy circumstances are very much related to the different pace of the two recoveries.

—*Wall Street Journal* editorial, 9/22/10

"Slump Over, Pain Persists" read the *Wall Street Journal* headline the day after the announcement in September that the Great Recession had ended back in June 2009.

The editors' reaction? Let's have more tax cuts and deregulation, the very policies that brought on the recession. Their reason? Because the first year of recovery from the 1981-82 recession, following the Reagan tax cuts, was far more robust than the Obama recovery has been so far.

But before you get nostalgic about the Reagan recovery, read the fine print.

To begin with, while the 1981-82 downturn was lengthy and severe, it was no Great Recession. No financial collapse, as even the editors allow, is one profound difference. Others include less drop-off in output, fewer jobs lost, and less long-term unemployment.

Climbing out of a smaller hole than the one left by the Great Recession, the Reagan recovery did manage to post economic growth rates that just matched those of the typical recovery since World War II, something the Obama recovery has not done. But how much of that growth can rightly be attributed to tax cuts?

The answer is, not much. Enacted in 1981, the Reagan tax cuts slashed corporate and individual income tax rates, with the biggest cut in the top rate. "Reaganomics" claimed that drastic tax cuts would restore prosperity by encouraging work, savings, and investment.

But when mainstream economists, such as Barry Bosworth and Gary Burtless of the Brookings Institution, looked closely, they found that something quite different had happened. After the 1981 tax cuts, savings rates actually plummeted. There was no boom in investment, since the tax cuts created large deficits that drove up interest rates, in turn discouraging investment. Men did work somewhat more and married women in particular worked longer hours, yet most saw no increase in their earnings.

What Reagan's tax cuts and other economic policies did do was to usher in an era of rising inequality. During the 1982-89 expansion, the share of total income gains that went to the richest one percent of households exceeded the share going to the bottom 90% for the first time since the 1920s.

The editors do not cite the next round of pro-rich tax cuts, passed in 2001 and 2003 during the Bush administration. That's probably because they were nearly devoid of expansionary powers. From 2001 to 2007, the U.S. economy grew more slowly and created fewer jobs than during any expansion since World War II. This was also the only expansion in 60 years that failed to lift real median household income.

If those dismal results are not enough to convince you that more tax cuts are the wrong medicine, consider this. Today, tax rates for the rich—the top income tax bracket, estate taxes, and dividend and capital gains taxes—are lower than they were *after* the Reagan tax cuts, and would remain so even if the Bush tax cuts for families with incomes over $250,000 were allowed to expire. So much for the economic-growth magic of low tax rates.

It is not taxes or overregulation but poor sales that are the largest single problem facing small businesses, according to the National Federation of Independent Business. But boosting sales remains no mean feat. With persistent high unemployment, wages virtually frozen, and foreclosures continuing unabated, there is no reason to expect consumer spending to rescue the U.S. economy.

Additional government stimulus spending would help, but more than that needs to be done: the deregulatory, inequality-inducing policies initiated during the Reagan recovery need to be undone. And what better place to start than with eliminating the Bush tax cuts for the rich. D&S

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**SOURCES:** Barry Bosworth and Gary Burtless, "The Effect of Tax Reform on Labor Supply, Investment, and Savings," *Journal of Economic Perspectives*, Winter 1992; Avi Feller and Chad Stone, "Top 1 Percent of Americans Reaped Two-Thirds of Income Gains in the Last Expansion," Center on Budget and Policy Priorities, Sept. 9, 2009; NFIB Small Business Economic Trends, Sept. 2010.

# Underwater

## Profits and pay are sky-high, even as bad loans are sinking the megabanks.


BY ROB LARSON

SINCE THE CATASTROPHIC BANK COLLAPSES OF 2008 AND THE GOVERNMENT RESCUE of the finance industry, Wall Street has staged a dramatic comeback. Since the bailout, profits are up, capital reserves are up, stock prices are up, government direct aid has been paid back, and executive compensation is exploding. But a closer look shows bank stability is just skin-deep, and dense accounting rules hide a powder keg of bad debt and mounting funding issues. While the recent paper-thin re-regulation of finance was a major political victory, the banks' core business is headed downhill and even worse trouble seems to lie ahead.

All of the big four U.S. megabanks—Bank of America, Citigroup, Chase, and Wells Fargo—reported either decreases or very modest increases in their massive profitability during 2010. But this surprisingly weak performance would have been even more disappointing without a pair of accounting maneuvers. One was a bookkeeping measure allowing banks to book projected profit from buying back their debt when their bonds become cheaper. But the banks rarely buy back their debt, so this is essentially a paper gain. The other penstroke that boosted profit was consumption of money set aside to protect against losses on loans—as banks have grown more outwardly confident about the economic recovery, they have lowered their stated expectations of bad loans and designated some of their capital cushions as profit.

But these shallow techniques for elevating profit weren't enough to compensate for the decline in banks' core business—interest income, the money collected from loans minus that paid out to depositors. That income has consistently dropped this year, mainly due to falling loan volume. Banks are making fewer loans to consumers and businesses, citing a "lack of demand," which obscures the quite favorable credit rating now required to get a loan. The lower supply of qualified applicants as job losses persist, combined with locking out applicants with spottier credit history and a general consumer preference to reduce total debt, have all caused bank loan books to continue to shrink in the feeble recovery.

The market has not rewarded the banks for the elaborate camouflage of this core weakness, and their stock prices have lately sagged as a result. But executive compensation is another story, and traders' pay is also rebounding into the $200,000-to-$500,000 range, while tens of millions of Americans struggle to keep food on the table. Meanwhile Obama's much-hailed ›› "pay czar" in charge of monitoring finance executive compensation, Kenneth Feinberg, has reported that within three months of receiving their bailouts, the megabanks had paid out $1.6 billion in bonuses—up to a quarter of their TARP rescue totals. However, the "czar" has no formal power to rescind exorbitant pay now that the majors have repaid their government capital infusions, and compensation will now be monitored by a rather unintimidating consortium of regulators. With the CEOs of the banking majors making about a million a year each in straight salary, no upward limit is in sight for financier compensation. But the banking institutions themselves may have some bumpy days ahead.

**The recent reforms may take the financial system back to short-term stability, but banks remain stuck with significant bad loans limiting core interest income, and continue to rely on market bubbles and on their outsized political power.**

### Extend and Pretend and Descend

While the banking majors were relieved of much of their bad home mortgage-based investments by government purchases in the course of the financial crisis and aftermath, large loans related to commercial real estate remained on their books. Many of these loans were to growing businesses and over-optimistic developers, and have frequently failed to perform, as the recession has rendered projects unprofitable, reducing borrowers' ability to repay.

But the loans are often for sobering amounts, upwards of tens of millions of dollars, and rather than foreclose on such large credit lines, banks large and small are engaging in what has come to be called "extend and pretend." The practice involves not taking legal measures on underperforming commercial real-estate loans, but rather "restructuring" loans with new, more favorable terms for the borrowers, like below-market interest rates or extended timelines for repayment. The goal of the practice is to prevent foreclosure on large loans, with the hope that extending maturities will give borrowers enough time to recover their business and repay.

There are several problems with this practice. First, it conceals the real condition of the commercial real-estate market. Second, the restructured loans are usually still foreclosed upon in the end—in first quarter of fiscal year 2010, 44% of restructured loans were still a month or more delinquent, a fact related to the startling two-thirds of commercial real-estate loans maturing by 2014 that are underwater—meaning that the property is worth less than the bank loan itself. Finally, the bad loans take up space on bank balance sheets that could go to real lending. This suggests that the banks' current predicament may lead to a miniature version of 1990s Japan, where refusal to accept real-estate loan losses led to a decade of slow growth, in part due to banks' inability to make fresh loans when demand recovered.

However, the "extend and pretend" policy presents one major benefit to the big banks: restructuring these loans allows banks to count them as "performing" rather than delinquent or worse, which means banks may reduce their capital reserves against losses. This enables banks to claim their capital cushions as profit; banks remain in denial about their bad loans, and this itself allows the recent profit increases. And when banks are one day obliged to confront these serious losses, they may find they no longer have the capital cushion to absorb the damage.

This ominous hidden liability is on top of the better-publicized problem of banks' under-performing residential mortgage holdings. The mortgage delinquency rate is now hovering around 10% nationwide, and including those behind on payments and those on the verge of eviction, fully one U.S. mortgage in seven is in some kind of trouble. Importantly, the bad mortgage debt on banks' books has ceased to be a primarily "subprime" phenomenon of low-income loan recipients; over a third of new foreclosures early this year were prime fixed-rate loans, as the layoff-intensive recovery pulls the rug out from under mortgage recipients.

Notably, the home mortgages still held by the banks are listed on bank balance sheets at inflated values since they are for homes bought at the housing bubble peak, and government has not forced the banks to account them at any reasonable value. And beside this additional hidden weakness and the space taken up on bank balance sheets by this bad mortgage debt, the banking majors are vulnerable to moves by insurers and other investors to force the banks to repurchase securitized home loans sold to them at wildly inflated prices. So far, losses on affected and expected repurchases have cost the biggest four U.S. banks nearly $10 billion, with further losses anticipated.

Meanwhile, the banks have allowed extremely few mortgage borrowers to modify their mortgages or reduce their principal—the National Bureau of Economic Research has found that just 8% of delinquent borrowers received any modification, while a pitiful 3% have received reductions in their total owed

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## One Hand Regulates the Other

July's Wall Street Reform and Consumer Protection Act was expected to be a return to at least moderate finance regulation, even if a far cry from the more sweeping controls of the 1930s. But the slap-on-the-wrist nature of the bill became clear when stock prices of the megabanks rose 3% on its passage. The bill delegates dozens of important decisions, from what constitutes a systemically important bank to credit ratings disclosure, to the regulatory agencies themselves. Crucially, bank regulators are expecting what the press calls a "lobbying blitz," as former employees of the regulators are bankrolled by Wall Street to lobby for industry discretion and relaxed standards on every rule. Highlights include:

- While now stuck with limits on overdraft fees and the "interchange fees" charged to merchants for debit card processing, banks are phasing out free checking accounts and elevating fees elsewhere, since they have the market power to do so. Many depositors are unable to afford checking account fees, of course, but the *New York Times* expects the banks to "jettison unprofitable customers."
- The Volcker Rule would limit banks' "proprietary trading," investments made with a bank's own money rather than clients' funds. The practice was damaging during the financial crisis, but banks have already found a work-around for the new rule. Banks are moving star proprietary traders to client desks, where they will primarily conduct derivatives trade for clients, but will also be able to engage in the barred practice on the side, further blurring the client/proprietary distinction.
- Derivatives will now be listed on established indexes and will require collateral as a cushion against losses, having previously been traded ad-hoc by individual banks. This removes significant risk from the banks themselves, reducing them to competing on service rather than generating large securitization fees. Importantly, businesses that use derivatives for legitimate purposes, such as farmers buying futures contracts to secure favorable grain prices, are exempted from the bill's indexing and collateralizing requirements.
- The bill includes a resolution authority that gives regulators a procedure to "unwind" a bank—overseeing its bankruptcy in an orderly fashion and at its creditors' expense. Additionally, the Kanjorski amendment to the bill gives regulators the authority to break up any financial institution considered to be a systemic threat to the financial system. But it seems unlikely that regulators, typically close to the firms they regulate, would let a titan go down regardless of their resolution authority.
- The new Consumer Financial Protection Bureau requires more information transparency from banks in their communications with customers. However, despite apocalyptic predictions from bank spokespeople, it is notable that banks with under $10 billion in assets are exempt from its rules. This excludes the small and medium-sized lenders that make up 98% of U.S. banks, but does include the large proportion of the industry run by the majors.

*Sources:* Congressional Oversight Panel, Small Banks In the Capital Purchase Program, July 14, 2010; Eric Dash and Nelson Schwartz, "Banks Seek to Keep Profits as New Oversight Rules Loom," *New York Times*, July 15, 2010; Aaron Lucchetti and Jenny Strasburg, "What's a 'Prop' Trader Now?—Banks Move Those Who Wager With Firms' Money to Client-Focused Jobs," *Wall Street Journal*, July 6, 2010; Randall Smith and Aaron Luchetti, "The Financial-Regulation Overhaul," *Wall Street Journal*, June 26, 2010; Damian Paletta, "Late Change Sparks Outcry Over Finance-Overhaul Bill," *Wall Street Journal*, July 2, 2010; Michael Phillips, "Finance Overhaul Casts Long Shadow on the Plains," *Wall Street Journal*, July 14, 2010; "Killing Them Softly," *The Economist*, August 26, 2010; "Not All On the Same Page," *The Economist*, July 1, 2010; Eric Lichtblau, "Ex-Regulators Get Set to Lobby on New Financial Rules," *New York Times*, July 27, 2010.

principal. However, about half of all seriously delinquent borrowers have had foreclosure proceedings brought by their bank. Of course, banks ultimately benefit more from a renegotiated loan that is paid off than from a foreclosure, but the long timeline required in the foreclosure process allows the banks to once again push back acknowledgement of the loss.

The banks' rush to foreclose is reflected in the recent suspension of the practice by several megabanks, after discovery that foreclosure standards were not being followed, with single employees overseeing upwards of 400 foreclosures daily, far more than can be properly reviewed according to legal standards. The investigation by state attorneys general adds to the legal swamp that may slow down the flood of foreclosures, but also testifies to the large banks' preference for foreclosure over loan modification.

### Lending On Borrowed Time

Banks face other market difficulties in the near future. One involves the increased reliance of the large banks on short-term borrowing to fund their loan portfolios. While banks have issued bonds to raise loan capital for years, in recent years they have grown increasingly dependent on short-term borrowing—the average maturity of recent bank bond issues is under five years, the shortest in decades. This is in fact why the seizing up of the credit markets in 2008 was such a big deal—banks were in immediate trouble if they couldn't borrow. Of course, the government bailout included guarantees for short-term bonds, leading the banks to become even more reliant upon them.

This means banks must "turn over" their debt more frequently—they must issue fresh bonds to raise capital to pay off the maturing older bonds—and U.S. banks must refinance over a trillion dollars through 2012. The problem is that the banks will be

## Basel Faulty

The Basel III bank guidelines are meant to be the G-20's coordinated global response to the crisis of 2008, establishing consistent rules limiting banking risk. But like the American bill, the lightweight standards were greeted by stock jumps for the bank majors, since the process was heavily influenced by massive financial industry lobbying and other, nationalist factors.

Perhaps most notably, the biggest banks' minimum leverage ratio—how much hard capital banks must hold to cushion against sudden losses—has been set at a modest 7% of assets. However, banks need not meet this requirement until 2019, with only a 2.5% requirement by 2015. Further, the Basel Committee has caved to industry demands to count assets like deferred-tax funds, mortgage-service rights, and investments in other firms as capital. These are now allowed to make up 15% of a bank's capital cushion, despite being illiquid and thus not very helpful in a crisis. Notably, some U.S. megabanks had reserve levels close to these on the eve of the finance crisis, and of course found them to be insufficient.

A related issue is how much long-term funding (vs. short-term bonds) the banks issue, making them less-vulnerable to sudden credit-market lockups as in 2008. The committee failed to reach agreement on this issue, and the rule has been postponed until 2015, along with many others, including "calibration," the specific required reserve level banks must maintain based on their importance to the overall finance system.

One obstacle to progress is the distinctly nationalist approach taken by the regulators, who aim to minimize the weight of regulations that will affect the banks based in their home countries. The United States has pushed aggressively for broader definitions of capital, since U.S. banks still hold large volumes of mortgage-securitization rights. Germany wants "flexible" enforcement of the reserve requirements for its undercapitalized banks; France wants allowances for its banks to continue to own insurers, and so on. The result is banking regulators fighting tooth and nail against regulating their own banks.

In this way, the standards meant to prevent banks from reverting to their old systemically risky ways have been heavily diluted, diminishing Basel to a fig leaf. As the *Wall Street Journal* accurately predicted, "significant moves by the Basel Committee to back away from its initial proposals…[are] likely to provoke criticism that regulators are caving to industry pressure and missing a chance to impose restraints that could reduce the risk of future costly crises."

*Sources:* Damian Paletta and David Enrich, "Banks Gain in Rules Debate," *Wall Street Journal*, July 15, 2010; Damian Paletta and David Enrich, "Risks Rulebooks Is Nearly Done—Key Aspects of Banks' New Restraints Are Agreed Upon," *Wall Street Journal*, July 27, 2010; Damien Paletta, "Banks Get New Restraints," *Wall Street Journal*, September 13, 2010.

competing with huge bond rollovers from state and federal government, which are heavily indebted because of upper-class tax cuts, as well as expensive wars and recent rounds of stimulus at the federal level. Even the powerful megabanks may struggle in this environment—as the *New York Times* puts it, "The cost of borrowing is likely to rise faster than banks can pass it on to customers." The total demand for institutional credit may significantly spike in coming years, meaning perhaps higher interest rates as states and finance houses compete for the bond market's favor, or a further decline in lending by banks due to prohibitive funding costs.

Meanwhile, smaller banks have experienced a different post-crisis environment. Despite some TARP bailout crumbs, they have gone under in record numbers—140 failed in 2009, with 2010 on track for a yet larger figure. Most of these smaller fry succumb to losses or suffocate under bad loans following the real-estate bubble of the last decade. This sector of the industry is ironically on track to cause more taxpayer losses from non-repayment of bailout funds than the majors, which have attracted the most scorn for taking TARP funds.

Compounding these stabilized but still shaky banking positions, the industry is now subject to a significantly reshaped regulatory environment. In addition to the major finance reform bill enacted in July, banks face new international capital standards in the Basel Rules and new regulatory scope for the Federal Reserve as well. But all these reforms have been limited by massive lobbying spending by Wall Street, coming to over $700 million in the last 18 months alone, as estimated by the Center For Responsive Politics. (See sidebars.)

A crucial part of the picture is the uncertainty caused by the notorious secrecy of the financial world. Large parts of the modern finance system do not accept deposits as commercial banks do, and therefore face far less regulation, allowing them to disclose much less information about their investments and leverage. Additionally, even the commercial banks are not obliged to report changes to the terms of their commercial real-estate holdings, obscuring the full extent of "extend-and-pretend" practices. And the Federal Reserve, for its part, has fought to preserve its own institutional secrecy. The Wall Street reform bill does include provisions for limited audits of the Fed's open-market operations and discount window, the basic monetary policy tools used to manipulate interest rates and to modulate economic activity. But this casts little light on the Fed's expansive holdings in mortgage securities and other paper bought from the banks in the course of the 2008-9 bailout. From the banks to the regulators, secrecy—and thus uncertainty—colors the picture.

In the end, moderately higher capital requirements and the public listing and indexing of derivatives may take the financial system back to short-term stability, but banks remain stuck with significant bad loans limiting core interest income, and continue to rely on market bubbles and on their outsized political power. They also face a difficult short-term bond market in the near future in addition to some higher regulatory costs, and crucially, their core business is further limited by weak credit demand in the low-expectations recovery. Unsurprisingly, compensation has rocketed back into seven figures in spite of these circumstances.

So while ordinary Americans limp along in a jobless recovery, the banks have their execs instead of Hell to pay. D&S

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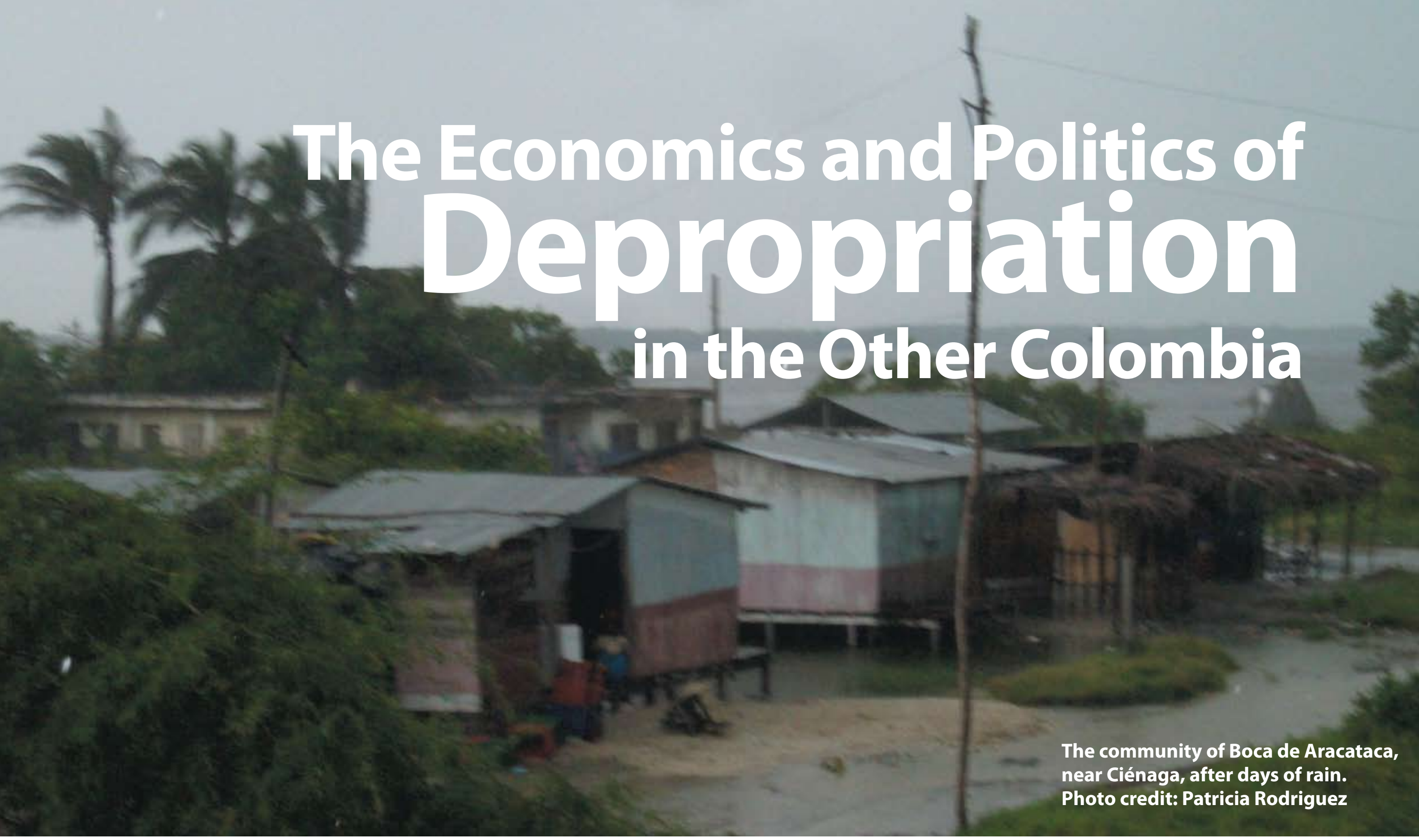
**SOURCES:** Eric Dash, "JPMorgan Chase Profit Rises as Loans Provisions Fall," *New York Times*, October 13, 2010; Eric Dash, "Citigroup Reports $2.2 Billion Profit in Third Quarter," *New York Times*, October 18, 2010; Bradley Keoun, "Bank Profits Are Worse Than They Look," *Bloomberg Businessweek*, July 22, 2010; Matthias Rieker and Marshall Eckblad, "Banks Generate Profits, but Struggle to Lend," *Wall Street Journal*, July 22, 2010; Eric Dash, "Federal Report Faults Banks on Huge Bonuses," *New York Times*, July 22, 2010; "Bankers' Pay," *New York Times*, July 27, 2010; Carrick Mollenkamp and Lingling Wei, "To Fix Sour Property Deals, Lenders 'Extend and Pretend,'" *Wall Street Journal*, July 7, 2010; David Streitfeld, "Mortage Data Leaves Bankers Uncertain of Trend," *New York Times*, May 19, 2010; Floyd Norris, "Banks Stuck With Bill for Bad Loans," *New York Times*, August 19, 2010; Manuel Adelino et al, "Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Curse and Securitization," NBER, July 2009; Jack Ewing, "Crisis Awaits World's Banks as Trillions Come Due," *New York Times*, July 11, 2010; AP, FDIC Closes 6 Banks, Including 3 in Florida," *New York Times*, July 16, 2010; Randall Smith and Robin Sidel, "Banks Keep Failing, No End in Sight," *Wall Street Journal*, September 27, 2010; Binyamin Appelbaum, "Mortgage Securities It Holds Pose Sticky Problem for Fed," *New York Times*, July 22, 2010; Peter Goodman, "Policy Options Dwindle as Economic Fears Grow," *New York Times*, August 28, 2010; Center For Responsive Politics, Lobbying Spending Database, FIRE 2010, opensecrets.org.



The community of Boca de Aracataca, near Ciénaga, after days of rain. Photo credit: Patricia Rodriguez

# The Economics and Politics of Depropriation in the Other Colombia

BY PATRICIA M. RODRIGUEZ

IT HAS RAINED FOR DAYS, AND THE SWAMPY OCEAN WATERS THAT SURROUND this community of displaced fishermen in northern Colombia rise at their own whim, flooding people's houses and making life even harder than usual. Yet most of the families living in this tiny makeshift encampment in Boca de Aracataca in the Magdalena province of Colombia have gathered under a tarp to eloquently tell a group of activists from Witness for Peace, a Washington-based social justice organization, about their problems. "[The foreign companies] kicked us out of our land. We do not have water, electricity, food, nor any help from the government...we need to be respected, we need to be treated as people, and not as animals," says Alicia Camargo, who has been displaced three times already, once very violently, along with family and neighbors.

As it turns out, the source of the problems in this community—and others nearby—is the presence of multinational corporations. In this particular case, it involves a new port expansion project along the Caribbean coast near the otherwise-idyllic city of Santa Marta. The construction of this mega-port has been funded by foreign coal companies that have operated practically unrestrictedly in Colombia for nearly 15 years. When it is finished in 2013, the port will allow U.S.-based company Drummond and Swiss-based Glencore to ship an extra 30 to 60 million tons of coal per year to global markets, in addition to the nearly 69 million tons they already export. The Colombian government allegedly receives a royalty of 10% of this total export profit, but only a handful of people see this money. A large portion of the money is never transferred to the communities that are most impoverished and environmentally affected by corporate presence. Still, foreign direct investment is embraced wholeheartedly by Colombian elites who equate corporate ventures in the agricultural, mineral, and industrial sectors with growth and prosperity.

It is not uncommon to hear about how corporations bring investment to developing countries and even their "willingness" to address problem areas such as environmental contamination and child labor practices. It is sometimes said that corporations' business practices are completely socially responsible and that corporations give back to the communities in which they operate. The media give much less attention to stories about how corporations destroy local lives, directly and indirectly. Yet it happens, and in some cases it leaves a trail of unimaginable destruction and violence. In this Caribbean region of Colombia, to talk of *displacement* of communities by corporations does not do justice to the reality; rather, locals speak of *depropriation*, or the takeover of property and livelihoods with complete impunity. In this corner of the world, multinational corporations in the coal industry like Drummond and Glencore, and in the banana sector, like Dole and Chiquita Brands (among others), are not just operating on the basis of government-granted licenses to exploit natural resources. Through alliances with authorities, legal and otherwise, these companies have crafted what amounts to an informal ownership of the region. They own a large part of the railroads, highways, ports, and mines, and they have little concern for how communities feel about their presence there.

But what is it about the nature of these enterprises and the context in which they operate that make for such dominance, and what facilitates their exploitation of workers and communities? How have local people resisted these infractions, and to what degree, considering the widespread corruption of their political representatives? To answer both these questions, it helps to understand more about the region. Whether due to its strategic location, its natural resources, or its distance from the centers of power in the capital city, Bogotá, this region is often referred to as "the other Colombia." It is an allusion both to its potential and to its stigma as something of a no man's land.

### Free Reign in the "Other Colombia"

Multinational companies began to arrive in the Magdalena and Cesar provinces in large part because the location offers such natural advantages. Surrounded in the east by the Sierra Nevada mountains, several municipalities in Magdalena province have direct access to the rivers that originate in these slopes. This makes the land well suited for banana plantations and other kinds of large-scale agriculture, and therefore for elite and corporate interests. It comes as no surprise that one of the U.S.-based companies with most presence throughout Latin America, the United Fruit Company (UFCO), operated in Magdalena since the beginning of the 20th century. As with its operations elsewhere, UFCO labor practices in Colombia were exploitative and repressive. During a strike by UFCO banana workers on December 6, 1928, in which they asked for better treatment and working conditions, an indefinite number of workers were massacred by company and police security forces in Ciénaga. The Nobel Prize-winning Colombian writer Gabriel García Márquez wrote a fictional account of this massacre in *One Hundred Years of Solitude*. Though UFCO left the Magdalena region in 1950s and moved to other regions of Colombia, it continued subcontracting with local growers.

In the mid to late 1980s, Chiquita Brands (formerly UFCO) and Dole rediscovered the *Zona Bananera*, or the Caribbean Banana Zone, at a time when local landowners had already been paying a "security fee" to rebel guerrilla groups that operated from the largely uninhabited Sierra Nevada, like the National Liberation Army (ELN). Noticing the potential for exclusive control of land and/or lucrative contracts with local large-scale banana growers, Chiquita and Dole officials negotiated economic deals with the landowners and security deals with the guerrillas. Their aim was to guarantee the companies' unrestricted access to highways and railroads leading to the coastal ports. In just a few years, however, small private security gangs began brutal confrontations with guerrillas in the mountains and the cities. Aware of their stronger firepower, the companies began to pay these small groups for protection instead of the guerrillas. By the late 1990s, these gang-style private security groups multiplied and fought each other for control of the territory (and for the substantial payments from landowners and multinational companies). A handful of gang leaders emerged victorious, and soon formed more structured paramilitary organizations like the powerful United Self-Defense Forces of Colombia (AUC). AUC and other paramilitary groups are known to have solid ties to drug lords as well as to military and high-level state authorities.

**In this Caribbean region of Colombia, to talk of *displacement* of communities by corporations does not do justice to the reality; rather, locals speak of *depropriation*, or the takeover of property and livelihoods with complete impunity.**

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One of the AUC leaders in the Caribbean region is Rodrigo Tovar, popularly known as Jorge 40. He was a former army official and comes from one of a handful of powerful traditional families in the region. In the mid 1990s, Jorge 40 began to work under the command of the Castaño family, who founded the AUC when the patriarch Jesús Castaño was kidnapped and assassinated in the mid 1990s by another guerrilla group, the Revolutionary Armed Forces of Colombia (FARC). To garner control, Jorge 40 was known to carry out "cleansings" of local communities in Magdalena and Cesar provinces, targeting anyone suspected of ties to ELN or FARC. In 2000, after a guerrilla attack on a group of business and mafia leaders in the town of Nueva Venezia, Jorge 40 ordered the massacre of 70 people from this community. According to witnesses, the armed paramilitaries then played soccer with victims' severed heads to show the community that they were in complete control. There are several others like Jorge 40 who have ties to the different landowning families and to different companies. In 2007, Chiquita Brands admitted in federal court that it paid nearly $2 million to paramilitary death squads over a period of seven years. On its end, Drummond is currently being sued in a United States court under the Alien Tort Claims Act for having contracted paramilitary forces to kill three union leaders. The violence in the region is widespread, and largely tied to corporate interest in acquiring lands and controlling the regions' vast resources. Between 1997 and 2007, 4,000 people died and at least 500 were disappeared. Moreover, during the height of the violence in between 2003 and 2006, 43,300 families from the region suffered forced displacement from their communities.

**Community members talking about the problems in Boca de Aracataca.**

**Photo credit: Patricia Rodriguez**

On their end, the companies suffered no major consequences from the bloodbath, other than occasionally having to rearrange their deals with different paramilitary leaders. As long as they kept scheduled payments, the companies enjoyed complete control over vast lands. By 2002 Chiquita and Dole decided to divvy up the 10,000 hectares of land in the *Zona Bananera*: the medium-to-large farms that grew bananas for Dole had their main houses painted red and white, and those that grew bananas for Chiquita were painted blue and white. They also happily shared the railroad. On the other hand, small farms that for one or another reason do not have contracts with these companies have hardly survived. Many peasants have agreed to sell their lands, only to lose most of their money to criminal and paramilitary gangs that extorted them shortly after the sale. Others, out of fear, have simply never returned after their violent displacement by paramilary groups. In the near future, these corporations are likely to continue to buy lands in the region, especially with the impending passage of the free trade agreement (FTA) between the United States and Colombia. While former president Alvaro Uribe championed the push for the FTA deal with the United States, current president Juan Manuel Santos, a former defense minister and a millionaire who has solid ties to many traditional elite Colombian families, is likely to deepen the open-borders approach.

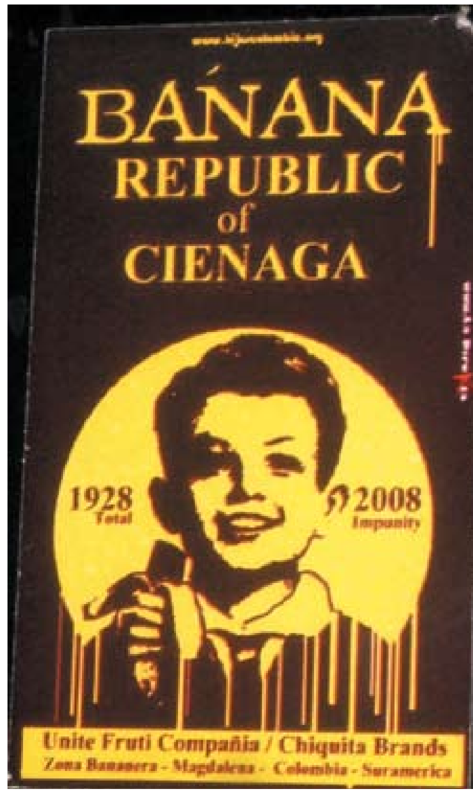
The free reign of foreign coal companies reflects a similar history. The mountainous terrain in neighboring Cesar province contains some of the biggest coal mines in Latin America. Drummond, Prodeco (a subsidiary of Glencore), and now Brazilian-owned Vale, have capitalized on this by buying part of the national railroad company FENOCO, so as to have unrestricted access to the approximately 300 miles of railroad line between the mines and the port of Ciénaga, near Santa Marta. The port installations now cover four kilometers (of a total twelve kilometers) of the coastal shores in Magdalena, but the mega-port currently under construction would extend them by another two kilometers. When the project got under way in 2008, several communities living in the swamps, or *ciénaga*, near the port were forcibly displaced by armed gunmen, and many ended in the encampment in Boca de Aracataca. The port expansion work has prevented the fishermen from being able to access close-by waters and they now have to fish in far away waters, if their boats are solid enough to make it there. The damage extends far beyond access. For years, the companies have been dumping millions of tons of coal onto communities where the railroad crosses, and into coastal waters. This is due to negligence, as residuals "accidentally" fall out when the coal is carried uncovered or dumped into the shipping containers. This has resulted in severe erosion and environmental contamination of local flora and fish. As if that did not suffice, Drummond was recently conceded the rights to Rio Toribio, including control over the station that supplies clean water to local communities. According to the fishermen, Drummond uses the water to wet down the coal so that it does not ignite in the containers on the way to global markets. This has generated the contamination of river water with coal dust, and has caused a variety of skin and respiratory diseases among the local population.

### State Complicity

This depropriation and destruction occurs under the protective eye of the Colombian state. Though laws exist which delimit any alterations to the agro-ecological balance in much of the coastal area, the government blatantly disregards the laws. In December 2007 the national Ministry of Transportation declared that the entire municipality was a public interest zone for purposes of national development, paving the way for the expansion of the port. Though Drummond and Prodeco appear to have followed all the legal steps to begin the expansion project, the process has certainly faltered in many aspects. According to a report prepared by local community leaders, the companies and municipal authorities did not adequately consult local community groups about worrisome environmental and socio-economic effects. Though the royalties for mining concessions and banana profits by law should remain in the communities for social and infrastructural investment, a majority of this money is simply distributed privately to national and municipal authorities. As a community leader from Ciénaga states, "what we have here is a case of mafia triangulation, with companies, the central government, and local authorities keeping the municipal funds for themselves, and thereby diffusing any responsibility that they should have towards communities."

The foreign companies do as they please, with impunity. When unionized coal workers organize to demand respect for their labor rights, or to ask for appropriate paid sick time for work injuries, the companies fire them. Such is the case of Moisés Padilla, a former Drummond employee who belongs to the SINTRAMINERGĖTICA (National Union of Industry and Energy Workers) union. He worked for 50 years as a welder (25 at Drummond), and is now incapacitated due to severe respiratory and heart conditions. The company has successfully resisted any outside intervention, despite legal efforts of the union. In a letter to Moisés Padilla, a company representative stated that it was not company policy to consent to third-party involvement, in this case a committee of independent and state officials that could evaluate his injury claims. Union workers have less and less job security, especially since the company has recently created its own union, SINTRADRUMMOND. Although the practice was previously prohibited, a recent judicial decision has opened a loophole for companies to begin organizing their own unions. Anibal Perez, another injured worker from SINTRAMINERGĖTICA, affirms that "for us to belong to our union is considered by the state practically a crime…the state does not give us the tools and protections to make our voices heard, and the result is that we have communities full of widows, orphans, and sick workers." The union has had five of its leaders killed since 2001, and several others now live in exile after being threatened by paramilitaries.

The companies are also quick to hold on to the façade of being socially and environmentally responsible. One example: Drummond trains a certain number of people from the community to be mine workers, but rarely hires local trainees. Some think this is because it is cheaper for the company to hire migrants from other regions. Similarly, national companies like AUGURA (Association of Banana Workers of Colombia) organize some of their own workers in seemingly beneficial cooperatives. Though independent on paper, AUGURA does business strictly with Dole, and prices are arranged between top level managers from AUGURA and Dole. So even if cooperative workers would truly get a fair trade price for their bananas, the lack of liberty to make autonomous decisions within the company-run cooperatives is problematic at best.




**A poster outside the office of a human rights organization in Ciénaga protests the "total impunity" of United Fruit Company/Chiquita Brands.**

**Photo credit: Patricia Rodriguez**

Not that state intervention would do any good. For one thing, much of the state funding for social programs for local communities is channeled to the companies themselves, such as the AUGURA-run cooperatives. So while the state has funds that it invests in social programs, these are mostly captured by the companies. Secondly, other state-funded social programs deliver subsidies as if community members were clients. The community at large, whether they belong to the category of low-income families, displaced families, or relatives and victims of violence, barely has access to a program that distributes about $40 every two months; most do not have enough of a connection with municipal authorities to receive even this small benefit. Thirdly, though the laws exist on paper to make the state more responsible and responsive, implementation is a problem. For instance, Colombia has had a Labor Statute since 1991, but the mechanisms for its implementation have not yet been discussed in Congress. Besides, corruption pervades the state. In 2009, a national scandal erupted over a government program aimed at helping struggling farmers, the Agro Ingreso Seguro (AIS) program. The funding (partly from the U.S. Agency for International Development) began in 2006 as part of an effort to ease concern over a potential negative impact of an impending FTA with the United States, but small farmers were not the ones benefiting; the bulk of AIS' $630 million per year was discovered to be going to rich landowners, narco-traffickers, and mobsters.

## Organizing an Effective Resistance

Considering the pervasiveness of corporate interests, violence, and state complicity, what *can* the handful of community leaders, human rights defenders, and union workers do to organize effective resistance? The truth is that they cannot organize freely; their lives are threatened constantly. Despite the threats, is not so hard to understand why those who are still alive publicly denounce the companies, the Colombian government, and the United States for trampling on their dignity. "Our denunciations make us very public personas, and since we do not have money to pay for private security guards, speaking out publicly and internationally ironically gives us some sense of security," says Edgardo Alemán, a local human rights defender.

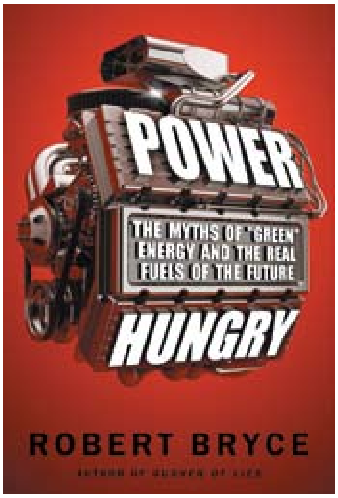
And so they *do* challenge, collectively when possible. One of the small victories of the SINTRAMIENERGÉTICA union and other allied groups has been the Collective Labor Agreement signed between the union and Drummond, for the years 2010-2013. Even at quick glance, it is easy to find the voice of the workers, and their concern for community. Article 7 states that when a job opens at Drummond, the company will give preference to skilled members of the local community; upon the death of a worker, the company commits to hiring a family member of the victim. Union leaders concur that the agreement feels more like "our list of demands" than an actual commitment by Drummond representatives. Yet many insist that a more effective interaction between the communities and the companies is the only solution. "We need to guarantee a way to capture the resources, to have a social development policy that favors our communities. If we go through the politicians, we will get nothing," says local activist and economist, Luís Eduardo Rendón.

If the state's lack of responsiveness is any indication, negotiating with the companies might in fact be a viable approach. But the success of that strategy does not depend on the amount of pressure Colombian workers and community leaders exert. In this sense, the context (and place) in which they operate limits their impact. For their voice to mean anything in a system dominated by elite power in Bogotá and abroad, it will take the U.S. government and global citizens en masse to press the companies (American companies!) and the Colombian state to be honest, and to practice their activities legally, with true social responsibility. Perhaps then there can begin to be justice for these communities in the other Colombia. D&S

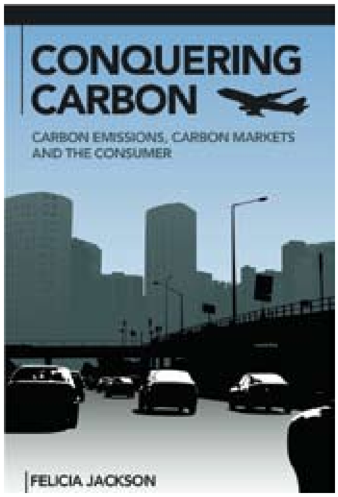
*PATRICIA M. RODRIGUEZ is an assistant professor of politics at Ithaca College.*

**SOURCES:** Luis E. Barranco, "Como el gobierno nacional convirtió una zona agroecológica en zona de interés público para fines portuarios," EDUMAG, Ciénaga, Colombia, 2010; Marcelo Bucheli, *Bananas and Business: The United Fruit Company in Colombia, 1899-2000*. New York: New York University Press, 2005; Peter Chapman, *Bananas: How the United Fruit Company Shaped the World*, New York: Canongate, 2007; Aviva Chomsky, Garry Leech, and Steve Striffler, *Bajo el manto del carbon: Pueblos y multinacionales en las minas de El Cerrejón, Colombia*, Colombia: Casa Editorial Pisando Callos, 2007.

# The Will to Power




***Power Hungry*** **by Robert Bryce. New York: PublicAffairs, 2010.**




***Conquering Carbon*** **by Felicia Jackson. London: New Holland Publishers, 2009.**

BY STEVEN PRESSMAN

As the 2007 *Stern Review* and many other studies make clear, few issues today are more pressing than greenhouse emissions and climate change. The Northern Hemisphere just suffered its hottest summer on record while BP decimated the Gulf of Mexico in pursuit of oil.

The two books under review here take very different approaches to this problem. One argues for natural gas and nuclear energy to support America's appetite for power, the other for limiting energy consumption and carbon emissions using pollution permits.

*Power Hungry* is a frustrating book. Its tone constantly shifts from scholarly to glib. Bryce also loves guilt by association. T. Boone Pickens is vilified for financing the 2004 Swift Boat ads against John Kerry; as such, his plan for generating power through wind must be defective. Similar problems plague the main argument of the book. Bryce raises reasonable questions about renewable energy; then he presents his simple energy policy—"I'm in favor of air conditioning and cold beer." Don't get me wrong, I like AC and beer too. But this is *not* an energy policy.

When examining the environmental impact of production, economists typically follow Wassily Leontief, who modeled the economy as a set of interconnected parts (for more on this approach, see my book *Fifty Major Economists*). We need tires, windshields, etc. to make cars, as well as food and clothing for autoworkers. These goods require additional inputs, while all production yields pollution. Any changes in production will change input needs and pollution output, sometimes in unexpected ways. The hard work involves identifying these relationships.

Bryce is at his best when he follows this model. Raising questions about renewables may be the main contribution of his book. He argues that solar and wind power will neither increase U.S. energy independence nor make the environment cleaner. Wind turbines require parts produced from rare elements available mainly from China. Also, solar and wind are unreliable—sometimes the sun does not shine and sometimes the wind does not blow—and require backups. The best backup (easy and cheap to switch on and off) turns out to be the most polluting—coal. Biofuels are problematic too. Converting millions of acres of Indonesia into palm oil farms has destroyed tropical forests that convert carbon dioxide into oxygen and has led to the near extinction of several species.

Fearing the long-term consequences of mercury and lead contamination from burning coal, Bryce favors taxing coal emissions. But he opposes limiting carbon emissions because of conflicting scientific studies about the negative environmental consequences of carbon use and a debate that has become politicized.

This agnostic stance leaves Bryce supporting increased hydrocarbon use (beer and AC) and living with the consequences of global warming. Natural gas and nuclear power become the best solutions for meeting our energy demand.

The case for natural gas is simple. New gas supplies are being discovered all the time and burning gas creates little pollution. However, gas extraction requires lots of water, which must be disposed of safely, and drilling has contaminated water supplies with arsenic, barium, and cobalt.

By default, only nuclear power remains. Nuclear generators can produce electricity as cheaply as coal or oil. They also emit no carbon dioxide. Their main downside is, of course, waste management. Bryce contends that problems with handling nuclear waste have been solved, although a long-term solution will require money and support from Congress. This support includes deciding where to bury nuclear waste. Bryce vociferously complains about resistance from local communities and political leaders, such as Senate Majority Leader Harry Reid, who oppose waste disposal sites in their home states.

At this point we come up against the biggest problem with Bryce's book. He supports power consumption at low cost because this is what Americans want. While this is true, Americans also want clean water and air, and they do not want nuclear waste buried in their backyard. Bryce would have written a much better book had he recognized these conflicting desires and tried to navigate through them.

*Conquering Carbon* provides a good antidote to *Power Hungry*. In contrast to the Nietzschean überman seeking more power, we encounter a Schopenhauerean will to live in the face of difficult obstacles. While Bryce takes disagreement among experts as an excuse to do nothing, Jackson sees doing nothing as a dangerous decision: "Cutting carbon emissions is about risk management."

*Conquering Carbon* begins by summarizing the existing scientific evidence for climate change and its consequences. The lesson from this literature is that the costs are so great, and the probability of environmental damage is so high, that we must quickly and significantly reduce per capita energy demand and greenhouse gases. This will require increased use of renewable energy, increased efficiency, and research leading to technological breakthroughs. It will also require changing the behavior of people and firms. Jackson provides numerous examples of what is possible.

Solar energy may not be a universal solution, but it can have limited uses. Rizhao (population 3 million), in northern China, uses solar water heaters in 99% of city homes. They cost about the same as electric hot water heaters, save money over the lifetime of the heater, and reduce electricity use and carbon emissions.

We can better manage the intermittency of solar and wind power with a large network of multiple plants at geographically separated locations. A smart grid can increase power from other sources when wind and solar power production are predicted to be low.

We can regulate car and appliance efficiency, develop better and cheaper public transportation, ban incandescent light bulbs, and insist on greater home energy efficiency. Systems that change the temperature and turn off lights when a room is empty would help. So would greater use of electric cars, which will require a national recharging network. And the cheapest way to reduce climate change is reforestation.

Most important of all, according to Jackson, we must put a price on carbon emissions through permits auctioned off by governments, and then traded by firms on a carbon market. The cost of buying these permits will increase the price of goods using a lot of carbon and will change consumption patterns in ways that benefit the environment.

Following most economists, Jackson sees several key advantages to cap-and-trade. Unlike government regulations, cap-and-trade pushes firms to *continuously* reduce energy use, since unused permits can be sold. It also stimulates technological innovation, since advances reduce carbon use and lower production costs.

Jackson does have some reservations concerning cap-and-trade. Firms may move production to countries without cap-and-trade; and if the price of permits is too low (for example during recessions), there will be little incentive for firms to improve their energy use. Here she may be too pessimistic. We can deal with firms moving abroad by compensatory taxes on imports, and we can reduce the supply of permits whenever their price falls.

On the other hand, Jackson fails to make a case for cap-and-trade over taxing carbon emissions. A carbon tax would have the same economic effects as pollution permits, but would not let Wall Street speculate on the future of our planet. In addition, some people perceive cap-and-trade as giving firms the right to pollute, but view taxes as a penalty for polluting; this psychological phenomenon might have an impact on real-world behavior in ways that reduce carbon emissions.

The best argument for cap-and-trade over carbon taxes is that cap-and-trade is usually *not perceived as a tax*. This might make it easier to pass legislation, especially when some permits are given away by the government. Alas, in the face of stiff Republican opposition last summer, the Obama administration decided to give up on passing a cap-and-trade bill. This raises an important political point that both books ignore—how to implement policy changes in a world with power hungry people and wealthy vested interests in opposition. To avoid the consequences of climate change, it seems we will need to develop a political will to power. D&S

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# The End of the Recession?

## How Blacks Might Fare in the Jobless Recovery

BY SYLVIA ALLEGRETTO AND STEVEN PITTS

There have been seemingly contradictory announcements recently concerning the economy. In September another 95,000 jobs were shed as the official unemployment rate remained at 9.6%. Unemployment has been at 9.5% or higher for well over a year now. About the same time this bad news about employment came out, it was announced that the recession, which began in December 2007, had actually ended in June of 2009—thus we are several months into the second year of recovery.

How could the recession be over, even amidst continued job losses and stubbornly high unemployment? And how might black workers, whose levels of unemployment have (as usual) been much higher than white workers' in this recession, fare in a "jobless recovery"?

### The Dating of the Business Cycle

The task of officially declaring the start and end dates of recessions is performed by the Business Cycle Dating Committee of the National Bureau of Economic Research. The Committee is currently comprised of seven economists (an eighth is on leave) from prominent universities. The Committee examines the data trends of several economic indicators, including measures of:

- Overall output
- Overall national income
- Total employment
- Aggregate hours worked

The Committee did not say that the economy had returned to its pre-recession level of activity or that the economy was strong; it just stated that the decline in several economic measures that began in December 2007 had ended and any new decline in economic activity would represent a new recession. That the economy is not officially in recession does not mean that it doesn't feel as if it is for many workers and their families. There is often not a palpable difference between a recessionary economy and a weak recovery—this is especially true with what are called "jobless recoveries."

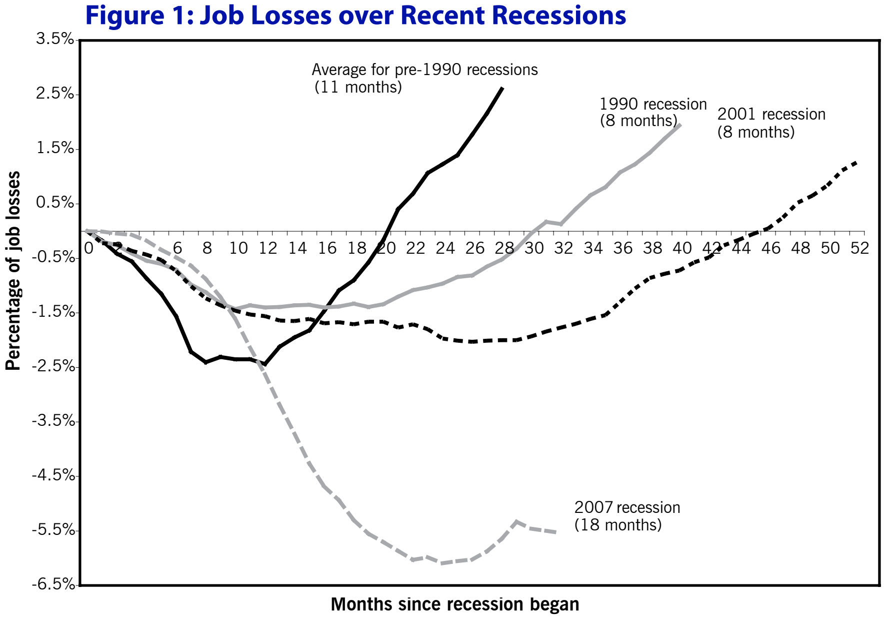
### What Is a "Jobless Recovery"?

An economy officially in recovery that continues to shed jobs as if in recession, or experiences prolonged tepid job growth, is deemed a "jobless recovery." In a jobless recovery it takes an inordinate amount of time to recoup the jobs lost during the downturn. While the recession officially ended in June 2009, the employment picture remains quite dismal. At the lowest point for jobs, in December 2009, 8.4 million jobs were lost, which represented 6.1% of all jobs. To date job losses are still at 7.7 million, which represents 5.6% of all jobs. Since the onset of recovery, the monthly employment reports have been mixed, but the net employment level has fallen by an additional 439,000.

Figure 1 depicts the dynamics of recessionary job losses and jobless recoveries. Each line represents the trajectory of job growth from the onset of recession until jobs were finally recouped (when the line crosses the horizontal axis—which represents months since the onset of recession). The solid black line represents average job losses for recessions prior to 1990. (On average the pre-1990 recessions were about eleven months long and it took about 21 months to recoup pre-recessionary job level.)

Job losses due to the 1990 recession (the solid gray line) were just about 1.5%—quite shallow comparatively and the recession was officially just eight months long. But employment lingered at the trough for a long time and it took about 31 months to recoup those lost jobs. The downturn in 2001 (dotted black line) was also eight months long and about 2% of jobs were lost—again

**Figure 1: Job Losses over Recent Recessions**




*Source:* Authors' analysis of Bureau of Labor Statistics, "Current Employment Statistics" (bls.gov/ces).

relatively mild—but it took 46 months to recoup those lost jobs.

It is clear from the chart that the recession that started in December 2007 (dotted gray line) led to a reduction in employment that far exceeded that of the previous recessions. This recession was 18 months long and ended in June 2009. Job losses were catastrophic. At its worst point jobs were down 8.4 million. Job growth turned positive in the spring of 2010—mostly due to the temporary hiring of Census workers. But shortly after Census workers were hired they were let go, and job growth once again turned negative. At this point it is clear that the labor market is in the realm of a jobless recovery—a prolonged period of negative or weak job growth. It will be a very long time before this economy recoups the enormous amount of jobs lost over this recession.

### How Might Blacks Fare in a Jobless Recovery?

While it is difficult to predict exactly what might happen to black workers during this jobless recovery, it is instructive to examine what happened to black unemployment during the last jobless recovery, which followed the 2001 recession. Figure 2 provides key information.

The gray bars in the chart mark key dates of the last two recessions and recoveries. In examining the trend in black unemployment since the 2001 recession, there are six key dates:

- The beginning of the recession (March 2001)
- The official end of the recession (November 2001)
- When job creation turned positive (September 2003)
- When the employment levels returned to pre-recession level (January 2005)
- The beginning of recession (December 2007)
- The official end of the recession (June 2009)

As Figure 2 indicates, unemployment rates continued to rise after the official end of the recession in November 2001. Over the jobless recovery—from November 2001 to September 2003—unemployment increased from 9.8% to 11% for blacks and 4.9% to 5.4% for whites. Black unemployment rates did not begin to steadily fall until the total number of jobs had reached the pre-recession level (January 2005). The unemployment rates for whites started to fall just prior to September 2003—near the end of the jobless recovery.

Starting with the onset of the 2007 recession, again the black unemployment rate increased at a faster rate than did that of whites. Since the onset of recovery—in June 2009—the unemployment rate of blacks has increased by 1.4 percentage points, from 14.8% to 16.2%. The rate for whites at the start of recovery was 8.7%, and after an initial increase it is back to that same rate today.

If the 2001 pattern holds, it may well be that the current black unemployment rates will not begin to significantly abate until the employment level returns to its pre-recessionary level of December 2007. This will almost certainly take several years as the shortfall in jobs is currently at 7.7 million. In order to return the national unemployment rate to its December 2007 rate, the economy would need to create 290,000 jobs per month for five years; so far this year job creation has averaged 68,000 per month, even as the last four months have averaged -98,000 per month.

In other words, for many black workers and their families, the recovery will continue to feel like a deep recession for many years to come. D&S

**Figure 2: Black And White Unemployment**
**For The Last Two Recessions And Recoveries**


Source: Authors' analysis of U.S. Census Bureau, "Current Population Survey" (census.gov/cps). Data are three month moving averages.

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RESOURCES: Bureau of Labor Statistics, "Current Employment Statistics" (bls.gov/ces); National Bureau of Economic Research, "The NBER's Business Cycle Dating Committee" (nber.org/cycles/recessions.html and nber.org/cycles/sept2010.html).

# Is China's Currency Manipulation Hurting the U.S.?

***Dear Dr. Dollar,***

***Is it true that China has been harming the U.S. economy by keeping its currency "undervalued"? Shouldn't the U.S. government do something about this situation?*** ***—Jenny Boyd, Edmond, W.Va.***

BY ARTHUR MACEWAN

The Chinese government, operating through the Chinese central bank, does keep its currency unit—the yuan—cheap relative to the dollar. This means that goods imported *from* China cost less (in terms of dollars) than they would otherwise, while U.S. exports *to* China cost more (in terms of yuan). So we in the United States buy a lot of Chinese-made goods and the Chinese don't buy much from us. In the 2007 to 2009 period, the United States purchased $253 billion more in goods annually from China than it sold to China.

This looks bad for U.S workers. For example, when money gets spent in the United States, much of it is spent on Chinese-made goods, and fewer jobs are then created in the United States. So the Chinese government's currency policy is at least partly to blame for our employment woes. Reacting to this situation, many people are calling for the U.S. government to do something to get the Chinese government to change its policy.

But things are not so simple.

First of all, there is an additional reason for the low cost of Chinese goods—low Chinese wages. The Chinese government's policy of repressing labor probably accounts for the low cost of Chinese goods at least as much as does its currency policy. Moreover, there is a lot more going on in the global economy. Both currency problems and job losses involve much more than Chinese government actions—though China provides a convenient target for ire.

And the currency story itself is complex. In order to keep the value of its currency low relative to the dollar, the Chinese government increases the supply of yuan, uses these yuan to buy dollars, then uses the dollars to buy U.S. securities, largely government bonds but also private securities. In early 2009, China held $764 billion in U.S. Treasury securities, making it the largest foreign holder of U.S. government debt. By buying U.S. government bonds, the Chinese have been financing the federal deficit. More generally, by supplying funds to the United States, the Chinese government has been keeping interest rates low in this country.

If the Chinese were to act differently, allowing the value of their currency to rise relative to the dollar, both the cost of capital and the prices of the many goods imported from China would rise. The rising cost of capital would probably not be a serious problem, as the Federal Reserve could take counteraction to keep interest rates low. So, an increase in the value of the yuan would net the United States some jobs, but also raise some prices for U.S. consumers.

It is pretty clear that right now what the United States needs is jobs. Moreover, low-cost Chinese goods have contributed to the declining role of manufacturing in the United States, a phenomenon that both weakens important segments of organized labor and threatens to inhibit technological progress, which has often been centered in manufacturing or based on applications in manufacturing (e.g., robotics).

So why doesn't the U.S. government place more pressure on China to raise the value of the yuan? Part of the reason may lie in concern about losing Chinese financing of the U.S. federal deficit. For several years the two governments have been co-dependent: The U.S. government gets financing for its deficits, and the Chinese government gains by maintaining an undervalued currency. Not an easy relationship to change.

Probably more important, however, many large and politically powerful U.S.-based firms depend directly on the low-cost goods imported from China. Wal-mart and Target, as any shopper knows, are filled with Chinese-made goods. Then there are the less visible products from China, including a power device that goes into the Microsoft Xbox, computer keyboards for Dell, and many other goods for many other U.S. corporations. If the yuan's value rose and these firms had to pay more dollars to buy these items, they could probably not pass all the increase on to consumers and their profits would suffer.

Still, in spite of the interests of these firms, the U.S. government may take some action, either by pressing harder for China to let the value of the yuan rise relative to the dollar or by placing some restrictions on imports from China. But don't expect too big a change. D&S

*ARTHUR MACEWAN is professor emeritus of economics at the University of Massachusetts-Boston and a* Dollars & Sense *Associate.*

**Questions about the economy? Ask Dr. Dollar!**

Submit your questions by email (*dollars@dollarsandsense.org*) or U.S. mail (Dr. Dollar, c/o *Dollars & Sense*, 29 Winter Street, Boston, MA 02108).