US bailout of mortgage giants: The politics of plutocracy

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For the second time in four months, the US government has intervened to rescue major financial firms and prevent an imminent collapse of the American and global banking system.

The government bailout of the mortgage giants Fannie Mae and Freddie Mac announced Sunday goes well beyond the $29 billion injection of Federal Reserve funds used to subsidize the takeover of Bear Stearns last March by JPMorgan Chase.

It not only demonstrates the depth of the economic crisis of American capitalism, it also provides an object lesson on the real relations of political power and influence behind the façade of American democracy.

The plan outlined by Treasury Secretary Henry Paulson would give him virtually unlimited and unilateral authority to pump tens of billions of dollars of public funds into the mortgage finance companies. At the same time, the Federal Reserve Board announced that it would allow the companies to directly borrow Fed funds.

It is generally conceded that a failure of the two government-chartered mortgage finance companies would have consequences even more cataclysmic than those which would have likely followed a collapse of Bear Stearns. Between them, Fannie Mae and Freddie Mac, which purchase mortgage loans from banks and other lenders, bundle them into securities and sell them to financial institutions and big investors around the world, hold or guarantee more than $5 trillion in mortgage debt. They currently account for some 80 percent of all new mortgages in the US. Were they to lose the ability to borrow at a discount, the US housing market would come to a grinding halt.

But even before that happened, US and global financial markets would face a meltdown, since thousands of US banks, hedge funds, pension funds and other institutions hold securities guaranteed by the two companies, and central banks, governments and private banks around the world are heavily invested in Fannie Mae and Freddie Mac debt.

Fannie Mae and Freddie Mac have been at the center of the housing market speculation that generated billions for Wall Street investors and CEOs and has now come crashing down, precipitating the greatest financial crisis since the 1930s. The two companies are massively leveraged, holding a combined $81 billion in capital to back the mortgages they own or guarantee—a ratio of capital to debt of 1.6 percent.

Their Ponzi scheme structures have been undermined by the collapse in home prices and the virulent spread of foreclosures. Over the past nine months they have lost a combined $11 billion and their stock has fallen by as much as 80 percent—a decline that turned into a rout last week as their stock values were cut nearly in half.

Their debacle is the latest and to date most spectacular expression of the decay of American capitalism. It is another refutation of the myths promoted by the US ruling elite about the miraculous workings of the capitalist market—supposedly the pinnacle of human achievement.

At the same time, it exposes the cynicism behind the official mantra of “free enterprise.” When it comes to big capital, losses are socialized. Only profits remain private.

That Fannie Mae and Freddie Mac are not isolated cases, but rather expressions of a systemic crisis, was underscored by the government seizure on Friday of IndyMac, the third largest bank failure in US history. According to some reports, as many as 150 other banks are close to collapse.

Paulson’s plan to use taxpayer funds to rescue Wall Street were worked out over the weekend in feverish closed door consultations between the Bush administration, the Fed, the big banks and investment houses and congressional leaders. They were under enormous pressure to come up with a plan before the Asian markets opened Monday, and the crisis atmosphere was compounded by the fact that Freddie Mac was scheduled to market $3 billion in short-term debt. A catastrophe was looming if the banks and investment houses refused to buy the company’s bonds.

There can be no doubt that Wall Street exploited the situation to extract from the government the broadest possible guarantees and assurances for its interests. But the entire scheme had to be sanctioned by the Democratic Congress, since it required changes in the charters and legal regulations governing the two companies.

The immediate and vocal support announced by key Democratic legislators for this massive taxpayer-funded bailout demonstrates the most important fact of American political life: the utter subservience of both parties and all of the official institutions to the financial aristocracy.

Rep. Barney Frank, the chairman of the House Financial Services Committee, proclaimed his agreement and pledged to have emergency legislation ready for Bush’s signature by the beginning of next week at the latest.

Senator Christopher Dodd, the chairman of the Senate Banking Committee, similarly signed off on the blank check for the mortgage giants. Senator Charles Schumer, a senior member of the Banking Committee, said, “The Treasury’s plan is surgical and carefully thought out and will maximize confidence in Fannie and Freddie while minimizing potential costs to US taxpayers.” He added that the plan would “be reassuring to investors, bondholders and mortgage-holders that the federal government will be behind these agencies should it be needed.”

The corporate-controlled media did its part to boost the scheme by portraying it for the most part as a boon to homeowners.

What does this response demonstrate? That when it comes to the vital interests of the financial aristocracy, the entire political system acts on command.

Suddenly, the much bemoaned "gridlock" in Congress vanishes. The Democrats, who have sought to explain away their repeated votes to fund the Iraq war by pointing to the supposedly insurmountable opposition of the Republicans to their "redeployment" plans, claiming "the votes aren't there" for their partial withdrawal schemes, now march in lockstep with the minority party to rush through laws demanded by Wall Street. Other initiatives, such as those on immigration, have died as a result of unbridgeable differences between punitive and even more punitive bills. But on this issue, Congress moves with military dispatch.

The emergency provisions demanded by Paulson are to be attached to Democratic-sponsored housing bills already passed in the House and the Senate. The contrast between the bailout for Wall Street and the measures for distressed homeowners in the original bills is instructive. The former provides the Treasury with a blank check to allocate perhaps hundreds of billions of dollars in public funds to prop up the banks. The latter does nothing to block foreclosures and, according to the Congressional Budget Office (CBO), will aid less than 20 percent of the 2.5 million homeowners who are expected to receive foreclosure notices this year. The CBO estimates that the total cost of the Democratic housing measures will be a mere $2.7 billion over five years.

There is nothing mysterious about the abject subordination of both Congress and the executive branch to Wall Street. Paulson, whose worth is estimated in the hundreds of millions, was chairman and CEO of Goldman Sachs before taking over the post of treasury secretary.

The Center for Responsive Politics reported in 2006 that about half of the Senate's 100 members were millionaires, with an average net worth of $8.9 million. In 2004, 123 members of the 435-member House of Representatives earned at least $1 million.

The buying of legislators and their votes by corporate interests is carried out openly and shamelessly. Members of Frank's House Financial Services Committee received over $18 million from financial services, insurance and real estate firms this year. Frank himself raised over $1.2 million, almost half of which came from finance and related industries.

Senator Dodd's top contributor in the 2003-2008 election cycle was Citigroup, followed by SAC Capital Partners. He raised $4.25 million from securities and investment firms.

Senator Schumer's top contributor was likewise Citigroup. He raised $1.4 million from securities and investment firms, his most lucrative corporate sector.

The government-corporate nexus is awash in corruption and bribery. This has grown apace with the so-called "financialization" of the US economy over the past three decades. The ruling elite has systematically scrapped large sections of industry and increasingly amassed its wealth through forms of financial speculation divorced from and destructive of the productive forces. The result has been an immense growth of financial parasitism alongside a brutal assault on the social position and living standards of the working class.

Social inequality has grown to unprecedented levels, along with a new financial aristocracy that dominates all aspects of public life.

The counterpart of financialization is the criminalization of the American corporate-financial elite. Fannie Mae and Freddie Mac—which have their roots in social reforms enacted during the New Deal—epitomize these twin processes. Virtually unregulated, they have engaged in massive speculation, bolstered by accounting fraud and bribery, to provide multi-million-dollar salaries for their top executives.

The former CEO of Freddie Mac, Leland C. Brendsel, paid $16.4 million in fines last year to settle charges of mismanagement at the mortgage company. The year before, the company paid a penalty of $3.8 million for illegal payments and perks to members of the House Financial Services Committee.

Fannie Mae, for its part, was fined $400 million for accounting manipulation from 1998 to 2004, during which time top executives reportedly received more than $90 million in bonuses.

Nor will the proposed bailout of these companies halt the deepening crisis of American and world capitalism. It will inevitably further undermine global confidence in the US financial system, intensify the crisis of the US dollar and stoke inflationary pressures. What is emerging is a crisis in which the solvency of the US government itself is called into question. As the *Wall Street Journal* put it on Monday, "But with financial woes mounting, some investors are betting they may profit from weighing an unthinkable question: Could the US government default?"

The bailout with public funds of Fannie Mae and Freddie Mac will set a precedent for a far broader use of taxpayer money to rescue major financial companies. Last week Paulson and Bernanke went before the House Financial Services Committee to demand legislation institutionalizing federal intervention to bail out failing Wall Street firms. The response of key Democrats such as Frank was to urge the regulators to call for such measures now, rather than after the new Congress takes office next year.

The cost of such bailouts will be borne by the working class, in the form of deeper cuts in social programs, education, housing and basic infrastructure, and new waves of corporate downsizing and wage-cutting.

The working class cannot defend its vital interests through pressure on the Democrats or any other institution of the American plutocracy. In the coming class battles, it must organize itself as an independent political force to fight for the socialist reorganization of society, including the transformation of the banks and finance houses into public utilities under the democratic control of the working population.