BIGGER THAN 9/11
By Michael Ventura
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When situations became unusually chaotic my mother used to say, "Close the doors, they're coming through the windows! Close the windows, they're coming through the doors!" In that spirit, these observations.

My Bad: T. Boone Pickens, Goldman Sachs, and, uh, me, envisioned an America in recession while world demand remained fairly strong, hence we predicted $200 a barrel oil by year's end. Oops. Others, whom I thought too pessimistic, saw America crash while the world tottered alongside, crushing demand and causing commodity prices (including oil) to drop drastically. They got it right, so far. Now Goldman Sachs predicts $50 a barrel "if the crisis deepens" (CNBC, Closing Bell, Oct. 13).

My Revised Forecast: This price drop is temporary. It may last as long as our recession, but the booby prize for the recession ending will be gas prices rising. Worst case: If the "BRIC" countries (Brazil, Russia, India, and China) regain their footing before we do, the price of gas will spike while we're still in trouble. That would be the economic equivalent of getting kicked while we're down. It could prolong our recession indefinitely.

The New Big Lie: A Big Lie is an untruth so simplistic it's easily grasped, repeated so often it becomes what everyone "knows." The New Big Lie about our crisis, in its crude form, blares from right-wing attack ads and the stump speeches of John McCain: We're in this mess because Fannie Mae and Freddie Mac screwed up by giving loans to poor folk, enabled by Democrats like Christopher Dodd and Barney Frank. Treasury Secretary Henry Paulson lies more gently when he speaks of "a chain of events *caused by* a housing correction" (CNBC, Closing Bell, Oct. 8, my italics).

Fannie Mae and Freddie Mac did screw up royally (I haven't space to cite how), enabled by enough Democrats and Republicans to field every ball club in the majors. However, contrary to the New Big Lie, the majority of inexcusable "subprime" loans went not to the poor but to middle- and upper-class white Americans (CNBC, Power Lunch, Oct 16).

The "correction" would no doubt have caused a good old-fashioned American recession - but, by itself, our housing correction wouldn't have stood the financial system of the developed world on its head, nor threatened a depression. Our crisis was not "caused by" the housing meltdown, but something else entirely: that pesky word “derivatives."

The Week summarized it handily (Oct. 10, p.11). You take out a mortgage. Maybe you can afford it, maybe you can't, but times are good so don't worry. "These mortgages were then bundled into securities… each security involved hundreds or thousands of individual mortgages, chopped into pieces." That "security" is an "asset backed derivative," the assets being mortgaged homes. Trouble is, each security involved so many mortgages, and each was bundled and sold so many times, no one knows what's in 'em, so no one knows their worth. When the financial world realized this, in August 2007, the crisis began. It steadily worsened because something that can't be assigned value can't be traded. So, eventually, credit markets froze. Currencies got shakier. Troubles multiplied. Then, as the ditty goes, "Ashes, ashes, all fall down."

Some saw it coming, as *The Week* reported: "Concern about financial derivatives first surfaced in the late 1990s, and congressional Democrats launched a drive to bring them under federal oversight. The effort was beaten back by Republicans led by then-Sen. Phil Gramm of Texas, who pushed through a law that explicitly exempted financial derivatives from federal regulations." (Look up Phil Gramm. You'll find he is John McCain's favorite economic advisor.)

For more than a decade, derivatives, hailed proudly as an American invention, were hugely profitable (again, no space to cite why). Those - like former Fed chairman Paul Volcker - who said derivatives were dangerous were shouted down as killjoys who just didn't get it. The developed world greedily ate up our derivatives. When derivatives finally went bad, well, "these instruments have brought the global financial system, improbably, to the brink of collapse" (*Newsweek*, Oct. 20, p.39).

In this recession (or depression), you and I will hurt. Maybe a lot. But that's not what will change history. This is:

The world learned modern capitalism from America. We were supposedly the experts. With modifications, our financial system was copied by, and intermeshed with, those of the European Union, Russia, China, Brazil, Dubai, Japan, etc. Maybe they didn't like us, and maybe they thought our day was ending as theirs dawned. But when it came to making money in a big way, they trusted us to know what we were talking about. They don't trust us anymore. We've put them all in danger. They won't forgive or forget. Lionel Barber, of the staid *Financial Times*, summed it up: "What's so special about this [disruption] is that it was made in America. America's credit rating, America's standing are going to suffer" (CNBC, Closing Bell, Oct. 15).

Bigger Than 9/11: On Monday, Oct. 13, Secretary Paulson and Fed Chairman Ben Bernanke invited the CEOs of our nine biggest banks to a meeting in Washington. The CEOs were not told why. "To their astonishment, they were each handed a one-page document that said they agreed to sell shares to the government, then [Paulson] said they must sign it before they left" (*The New York Times* online, Oct. 15). They argued, but they signed. The article goes on to note that "just days earlier" Paulson had vigorously rejected this plan. "Analysts say the United States was *forced to shift policy* [my italics] in part because Britain and other European countries announced plans to recapitalize their banks and backstop bank lending. But unlike in Britain, the Treasury secretary presented this plan as an offer the banks could not refuse."

"The U.S. government emerges as the nation's biggest bank investor" (CNBC, Street Signs, Oct. 15). “The U.S. banking sector will be tied to the federal government for years to come” (*The Wall Street Journal*, Oct. 14, p.1) First housing was semi-nationalized, then insurance, now banks. No one has a word for this. It's not socialism, but it's not American capitalism either. And it wasn’t our idea.

"Europe… set the pattern for the U.S. plan. If the U.S. did not act in a similar fashion, investors might have moved money abroad to seek safety" (*USA Today*, Oct. 14, p.1). We were forced by Europe to the "partial nationalization" of the banking system (BBC World News America) - "an astonishing move in the home of free market capitalism" (*Toronto Globe and Mail* online, Oct. 15). That article notes that the European Union is calling an international meeting next month, inviting our president-elect, for the purpose of "reforming the world financial order." In other words, they'll reform the system with or without us.

Then French President Nicolas Sarkozy and European Commission President Jose Manuel Barroso met with President Bush at Camp David. Bush agreed to the international meeting, and the three held a press conference announcing it would take place by year's end (Associated Press online, Oct. 18). Bush warned, "It is essential that we preserve the foundations of democratic capitalism." Standing right beside him, Barroso then said, "We need a new global financial order." (Translation: "We're not preserving *your* 'order.'") Sarkozy added that the present order "is no longer acceptable… no longer possible."

However Bush may posture, this meeting wasn't what America wanted; it was Europe's demand. The apparent compromise is that the meeting will be held in New York, but Sarkozy added a barely diplomatic jab: It's right that New York host the meeting, "insofar as the crisis began in New York." We started this. They intend to finish it. We'll go along because, in order even to have an economy, we must. We don't make the rules anymore.

History will record this crisis as more important by far than 9/11. The 9/11 attacks left us with many choices. We chose badly (the PATRIOT Act, the invasion of Iraq); but we did the choosing. The world begged us to do otherwise. We told them to shove it. But when Sarkozy says, "We want a new world to come out of this" (*Newsweek*, Oct. 20, p.25), and Germany's finance minister adds "that America [will] lose its role as 'financial superpower'" (*The Economist*, Oct. 4, p.55) - that's the sound of a fat lady singing.

The economic future of the United States is no longer in the hands of the United States.

[Correction: Perhaps because of Sarkozy's jab, the economic summit's venue has since been shifted from New York to Washington.]