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The Big Squander

Last week, the inspector general for the Troubled Asset Relief Program, a.k.a., the bank bailout fund, released his report on the 2008 rescue of the American International Group, the insurer. The gist of the report is that **government officials made no serious attempt to extract concessions from bankers, even though these bankers received huge benefits from the rescue. And more than money was lost. By making what was in effect a multibillion-dollar gift to Wall Street, policy makers undermined their own credibility — and put the broader economy at risk.**

For the A.I.G. rescue was part of a pattern: **Throughout the financial crisis key officials — most notably Timothy Geithner, who was president of the New York Fed in 2008 and is now Treasury secretary — have shied away from doing anything that might rattle Wall Street. And the bitter paradox is that this play-it-safe approach has ended up undermining prospects for economic recovery.** For the job of fixing the broken economy is far from done — yet finishing the job has become nearly impossible now that the public has lost faith in the government's efforts, viewing them as little more than handouts to the people who got us into this mess.

About the A.I.G. affair: During the bubble years, many financial companies created the illusion of financial soundness by buying credit-default swaps from A.I.G. — basically, insurance policies in which A.I.G. promised to make up the difference if borrowers defaulted on their debts. It was an illusion because the insurer didn't have remotely enough money to make good on its promises if things went bad. And sure enough, things went bad.

So why protect bankers from the consequences of their errors? Well, by the time A.I.G.'s hollowness became apparent, the world financial system was on the edge of collapse

and officials judged — probably correctly — that letting A.I.G. go bankrupt would push the financial system over that edge. So A.I.G. was effectively nationalized; its promises became taxpayer liabilities.

But was there any way to limit those liabilities? After all, banks would have suffered huge losses if A.I.G. had been allowed to fail. So it seemed only fair for them to bear part of the cost of the bailout, which they could have done by accepting a “haircut” on the amounts A.I.G. owed them. Indeed, the government asked them to do just that. But they said no — and that was the end of the story. Taxpayers not only ended up honoring foolish promises made by other people, they ended up doing so at 100 cents on the dollar.

Could things have been different? Some commentators argue that government officials had no way to force the banks to accept a haircut — either they let A.I.G. go bankrupt, which they weren’t ready to do, or they had to honor its contracts as written.

But this seems like a naïve view of how Wall Street works. Major financial firms are a small club, with a shared interest in sustaining the system; ever since the days of J.P. Morgan, it has been common in times of crisis to call on the big players to forgo short-term profits for the industry’s common good. Back in 1998, it was a consortium of private bankers — not the government — that put up the funds to rescue the hedge fund Long Term Capital Management.

Furthermore, big financial firms have a long-term relationship, both with the government and with each other, and can pay a price if they act selfishly in times of crisis. Bear Stearns, the investment bank, earned itself a lot of ill will by refusing to participate in that 1998 rescue, and it’s widely believed that this ill will played a major factor in the demise of Bear Stearns itself, 10 years later. So officials could have called on bankers to offer a better deal, for their own sake, and simultaneously threatened to name and shame those who balked. It was their choice not to do that, just as it was their choice not to push for more control over bailed-out banks in early 2009. And, as I said, these seemingly safe choices have now placed the economy in grave danger. For the economy is still in deep trouble and needs much more government help. Unemployment is in double-digits; we desperately need more government spending on job creation. Banks are still weak, and credit is still tight; we desperately need more government aid to the financial sector. But try to talk to an ordinary voter about this, and the response you’re likely to get is: “No way. All they’ll do is hand out more money to Wall Street.”

So here’s the real tragedy of the botched bailout: Government officials, perhaps influenced by spending too much time with bankers, forgot that if you want to govern effectively you have retain the trust of the people. And by treating the financial industry — which got us into this mess in the first place — with kid gloves, they have squandered that trust.

Paul Krugman, emphasis added

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Union News



AFL-CIO News service graphic(s) added

Gone with the Wind: Blowing U.S. Tax Dollars Off Shore: It turns out a Texas windmill farm developer's request last month for nearly half a billion in stimulus funds to create 2,000 jobs in China doesn't rank first on the audacity scale. Shockingly for American taxpayers, and sadly for the staggering 10.2 percent of Americans who are unemployed, it doesn't even rank second. That's because Washington already has doled out hundreds of millions in stimulus funds to foreign renewable energy firms. Of the \$1.05 billion in clean energy grants awarded by Washington, D.C., \$849 million—84 percent—went to foreign wind companies, according to an analysis by Russ Choma of the Investigative Reporting Workshop. He wrote: *The cash grants were given for the installation of 1,763 megawatts of capacity—1,566 installed by foreign companies. Using the Renewable Energy Policy Project's own numbers, as many as 4,500 manufacturing jobs may have been created overseas.*



Working America, Union Members Deliver for Health Care Reform: In Louisiana, Maine, North Dakota, Delaware, Arkansas and Indiana this week, Working America members and union volunteers are sending a message to their senators: You need to pass real health care reform. Working America and union members delivered thousands of handwritten letters to senators in these key states. On Tuesday in Louisiana, Wednesday in Arkansas and yesterday in four other states, these activists brought more than 15,000 letters to their senators in support of health care reform that expands coverage, doesn't raise costs for middle-class families because it doesn't tax their benefits and includes a public health insurance option to help hold insurance companies accountable.



Without Jobs, the Nation's Future Circles the Drain: After he was elected AFL-CIO president in September, Richard Trumka traveled around the country on a listening tour. Here's one story he heard, which he described this week as the AFL-CIO, along with several key allies, launched a jobs initiative to help get our nation back to work. Last summer at an event in Ohio, I met a young woman who is facing this crisis head-on. Lacey, who is not yet 20 years old, wants to become a teacher. But after her dad's factory closed and he was laid off, she had to put off her hopes of attending college to help her parents keep a roof over their heads. Lacey took a job in a school cafeteria—until the state budget got cut, and she got laid off, too. After months in which she and her father were both searching for jobs, Lacey said she felt lucky to find a part-time fast food job that pays half of what the cafeteria paid. Lacey has more unemployed friends than friends with jobs, and, like a third of workers her age, she's still living with her parents. Here's what Lacey said to me that day: *I wanted to*

be a teacher to help children get the education they need to get ahead. But now I feel like I'm just going backward myself. I'm really scared for the kids my age. We want to work. We need jobs.



The Rich Are Different. They Have Jobs:

Wall Street doesn't look back at the disaster it wrecked on Main Street. Goldman Sachs, one of the Wall Street firms that got the H1N1 flu shot well ahead of millions of America's school children, sent this health tip in a memo to its pampered, out-of-touch execs: "Resist the urge to open your own car door; let your driver do it." Yo, Jeeves. While you're at it, dust around the edges of those massive CEO pay packages. Because according to a report released today by the Government Accountability Office (GAO), top executives at four companies that jettisoned their employee pension plans received \$49.5 million in retirement and



severance benefits in the years before the companies filed for bankruptcy, while retirees saw their benefits cut by as much as two-thirds. Yet Wall Street bankers are making that cash flow keeps coming: Yesterday, writes David Dayen, Senate Republicans bowed low before their corporate masters and delayed a move by Sen. Chris Dodd (D-Conn.) to immediately take up a bill that would freeze all credit card rates, charges and fee increases.



Senate Health Care Bill: Moving in the Right

Direction: Around the country, union volunteers are taking grassroots action to get their senators to support real health care reform. Last Week, Senate Majority Leader Harry Reid (D-Nev.) officially released the Senate's version of health care reform legislation, a major step toward the health care reform bill America has been waiting for. It's an improved bill from the one passed by the Senate Finance Committee last month. It

still falls short of an ideal bill but, like the one passed by the U.S. House earlier this month, it greatly increases coverage, helps make health insurance more affordable and includes a public health insurance option to compete with insurance companies. AFL-CIO President Richard Trumka says Reid has shown courage and leadership in bringing a good bill to the full Senate. Trumka says the bill is a step in the right direction, because it would cover 31 million people, control costs, include a public option and cut \$127 billion from the deficit in the first decade. Trumka notes that unfortunately, while many of the bill's financing mechanisms are fair, it is still partially funded through a tax on health benefits.

Hundreds in Airline Industry Gain a Union Voice on the Job: More than 400 flight attendants and 170 pilots now have strong union voices after voting to join the Flight Attendants-CWA(AFA-CWA) and the Air Line Pilots (ALPA) in three elections, recently certified by the National Mediation Board (NMB). In the latest victory for airline workers, the 300 flight attendants at Compass Airlines voted 2-to-1 for AFA-CWA representation. Compass flight attendant Catriona Bagley, temporary president of the Compass local, says she and fellow flight attendants look forward to negotiating a contract that will provide security, as well as advance our careers. As AFA-CWA members, we will have a voice at the bargaining table and work alongside management in creating a leading regional airline contract that recognizes our role as safety professionals.



American Rights at Work Honors Sweeney, Employee Free Choice Champions:

AFL-CIO President Emeritus John Sweeney received the top honor at last night's 5th annual American Rights at Work Eleanor Roosevelt Awards for his long-term dedication on behalf of workers' freedom to form unions. Business Leaders for a Fair Economy and "West Wing" actor Richard Schiff also were recognized at last night's event in Washington, D.C., where hundreds of labor activists and our allies gathered to celebrate their outstanding leadership. Sweeney credited the union members, activists and advocacy groups who make up the coalition for making real progress on the Employee Free Choice Act: *You are the front-*

line fighters for social and economic justice; working towards a better future for America's working families. Speakers noted the tough fight ahead for passage of the bill but said we are closer than ever to passing the Employee Free Choice Act and making sure that the freedom to form a union and bargain for a better life is a reality.

Point Of View



Obama, China, and Wishful Thinking about American Jobs

President Obama says he wants to “rebalance” the economic relationship between China and the U.S. as part of his plan to restart the American jobs machine. “We cannot go back,” he said in September, “to an era where the Chinese . . . just are selling everything to us, we’re taking out a bunch of credit-card debt or home equity loans, but we’re not selling anything to them.” He hopes that hundreds of millions of Chinese consumers will make up for the inability of American consumers to return to debt-binge spending.

This is wishful thinking. True, the Chinese market is huge and growing fast. By 2009, China was second only to the U.S. in computer sales, with a larger proportion of first-time buyers. It already had more cell-phone users. And excluding SUVs, last year Chinese consumers bought as many cars as Americans (as recently as 2006, Americans bought twice as many).

Even as the U.S. government was bailing out General Motors and Chrysler, the two firms’ sales in China were soaring; GM’s sales there are almost 50% higher this year than last. Proctor & Gamble is so well-established in China that many Chinese think its products (such as green-tea-flavored Crest toothpaste) are Chinese brands. If the

Chinese economy continues to grow at or near its current rate and the benefits of that growth trickle down to 1.3 billion Chinese consumers, the country would become the largest shopping bazaar in the history of the world. They'll be driving over a billion cars and will be the world's biggest purchasers of household electronics, clothing, appliances and almost everything else produced on the planet.

So this will mean millions of American export jobs, right? No.

In fact China is heading in the opposite direction of "rebalancing." Its productive capacity keeps soaring, but Chinese consumers are taking home a shrinking proportion of the total economy. Last year, personal consumption in China amounted to only 35% of the Chinese economy; 10 years ago consumption was almost 50%. Capital investment, by contrast, rose to 44% from 35% over the decade.

China's capital spending is on the way to exceeding that of the U.S., but its consumer spending is barely a sixth as large. Chinese companies are plowing their rising profits back into more productive capacity—additional factories, more equipment, new technologies. China's massive \$600 billion stimulus package has been directed at further enlarging China's productive capacity rather than consumption. So where will this productive capacity go if not to Chinese consumers? Net exports to other nations, especially the U.S. and Europe.

Many explanations have been offered for the parsimony of Chinese consumers. Social safety-nets are still inadequate, so Chinese families have to cover the costs of health care, education and retirement. Young Chinese men outnumber young Chinese women by a wide margin, so households with sons have to accumulate and save enough assets to compete in the marriage market. Chinese society is aging quickly because the government has kept a tight lid on population growth for three decades, with the result that households are supporting lots of elderly dependents.

But the larger explanation for Chinese frugality is that the nation is oriented to production, not consumption. China wants to become the world's preeminent producer nation. It also wants to take the lead in the production of advanced technologies. The U.S. would like to retain the lead, but our economy is oriented to consumption rather than production.

Deep down inside the cerebral cortex of our national consciousness we assume that the basic purpose of an economy is to provide more opportunities to consume. We grudgingly support government efforts to rebuild our infrastructure. We want our companies to invest in new equipment and technologies but also want them to pay generous dividends. We approve of government investments in basic research and development, but mainly for the purpose of making the nation more secure through advanced military technologies. (We regard spillovers to the private sector as incidental.)

China's industrial and technological policy is unapologetically direct. It especially wants America's know-how, and the best way to capture knowhow is to get it firsthand. So

China continues to condition many sales by U.S. and foreign companies on production in China — often in joint ventures with Chinese companies.

American firms are now helping China build a “smart” infrastructure, tackle pollution with clean technologies, develop a new generation of photovoltaic’s and wind turbines, find new applications for nanotechnologies, and build commercial jets and jet engines. GM recently announced it was planning to make a new subcompact in China designed and developed primarily by the Pan-Asia Technical Automotive Center, a joint venture between GM and SAIC Motor in Shanghai. General Electric is producing wind turbine components in China. Earlier this month, Massachusetts-based Evergreen Solar announced it will be moving its solar panel production to China.

The Chinese government also wants to create more jobs in China, and it will continue to rely on exports. Each year, tens of millions of poor Chinese pour into large cities from the countryside in pursuit of better-paying work. If they don’t find it, China risks riots and other upheaval. Massive disorder is one of the greatest risks facing China’s governing elite. That elite would much rather create export jobs, even at the cost of subsidizing foreign buyers, than allow the Yuan to rise and thereby risk job shortages at home.

To this extent, China’s export policy is really a social policy, designed to maintain order. Despite the Obama administration’s entreaties, China will continue to peg the yuan to the dollar—when the dollar drops, selling Yuan in the foreign-exchange market and adding to its pile of foreign assets in order to maintain the Yuan’s fixed relation to the dollar. This is costly to China, of course, but for the purposes of industrial and social policy, China figures the cost is worth it.

The dirty little secret on both sides of the Pacific is that both America and China are capable of producing far more than their own consumers are capable of buying. In the U.S., the root of the problem is a growing share of total income going to the richest Americans, leaving the middle class with relatively less purchasing power unless they go deep into debt. Inequality is also widening in China, but the problem there is a declining share of the fruits of economic growth going to average Chinese and an increasing share going to capital investment.

Both societies are threatened by the disconnect between production and consumption. In China, the threat is civil unrest. In the U.S., it’s a prolonged jobs and earnings recession that, when combined with widening inequality, could create political backlash.

Robert Reich served as the nation’s 22nd Secretary of Labor and now is a professor of public policy at the University of California at Berkeley.

