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UA expert explains U.S. economy

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The nation's economic troubles of late have impacted Wall Street and consumers' wallets, leading to multi-million dollar government bailouts and fear for the future of the country. News reporter Joel Childers sat down with Christopher Lamoureux, head of the Eller College Finance Department, to discuss the possible outcomes of the current financial crisis and how it began in the first place.

Daily Wildcat: For students who are not following the news regarding the current state of the economy, please give a brief explanation of what is going on financially in America and in Wall Street.

Lamoureux: Since the summer of 2007, our financial system has been in a crisis mode. Most students would not see this. The (Federal Reserve) has been very aggressive since this time, acting to inject reserves into the system and trying to stabilize the system. In the spring this year, one of our major independent investment banks, Bear Stearns, was on the verge of collapse. The Feds stepped in to sort of arrange a takeover of Bear Stearns in May 2008. . . . That was followed this summer by Lehman Brothers and we have the department of treasury putting Fannie Mae and Freddie Mac into conservatorship, meaning (the) treasury has stepped in to essentially run what had been these private companies. . . . And now finally the Fed and the treasury are saying unless the government steps in in an even larger way, the entire financial system as we know it is literally on the verge of collapse.

DW: Was the government's bailout of mortgage giants Fannie Mae and Freddie Mac foreseeable?

CL: Yes and no. The original crisis is perhaps precipitated by the burst of the housing bubble. These government-sponsored enterprises, Fannie Mae and Freddie Mac, started doing activities that were much riskier than I think we would have perceived in their original charter. It is not at all surprising that Fannie Mae and Freddie Mac had financial difficulties that required government intervention.

DW: The government is now potentially seeking $700 billion to come from taxpayers' money to restore the economy. Are you an advocate of this plan?

CL: I want to point out, as far as I can see right now there is no plan in the sense that there is a very explicit proposal in terms of how the $700 billion will be used and what the supervision of the assets will be. There are over-arching themes, there are concepts in place, but I really think it would be foolish (for the taxpayer) to say, I am in support of it or I am opposed to it. . . . As I listen to Congress, I hear them saying: We shouldn't be bailing out the banking firms and the people who made the mistakes, but we should be shifting down the aid as we did in the 1930s to homeowners and taxpayers who are at risk. That's what I think the debate will focus on. The so-called "Paulson Proposal" seems to focus the aid into those institutions. Concerns are raised that secretary Paulson, formerly chief executive of Goldman Sachs, is Wall Street-centric in his views. Congress, I think, is much less worried about preserving Wall Street and perhaps much more willing to let the Wall Street firms reap the consequences of their actions.

DW: It seems that many arguments against the government helping certain financial institutions and

Wall Street, is (that) it goes against the fundamentals of capitalism and is more socialistic in its views.

CL: There is no doubt. That is neither good nor bad though. Capitalism is not inherently superior in its consequences or its organizational form than necessarily any other form of organization. One has to be careful not to necessarily associate those words or imbue them with some sense of quality. Look, markets fail and they have failed since capitalism's earliest days. The question is: how do we as a society deal with these market failures. . . . In the short term, if we do nothing the economy will literally be at risk of going into a rather severe depression. Are we more concerned with free-markets or are we more concerned about the consequences of today where it is much more easy for us to rationalize government intervention?

DW: What are the potential results if we were not to bail out Wall Street and if we keep a more capitalistic view - if we were more inclined toward the long run as opposed to the short run?

CL: The credit markets would collapse. We are at risk right now of a complete and total collapse of credit. This would mean small business would be entirely stymied. There would be a complete breakdown in the availability of capital for anyone who wanted to do something creative and productive with that capital, and it likely would last for years. So the nearest analogy that we have in history to something like this is the Great Depression.

DW: Is the government backing something of a last minute, or final resort, to prevent a second Great Depression?

CL: That is certainly what the treasury secretary and the Fed chairman have said. Is it a last ditch or last minute effort? Here is something that I have heard senators and congressmen complain about. Clearly, all of this has been going on for 14 months, if not longer, so why is it that on Monday of this week the treasury secretary and Fed chairman have come in saying we have to move now, time is short, time is of the essence, we are in an emergency situation, you better do what we are saying and you better do it now? Serious congressmen are sitting back saying why didn't we hear about this a year ago? I think that is a very legitimate concern. I don't think any of this is a surprise; there is nothing that happened over this past weekend that was not entirely predictable a year ago.

DW: Another argument against Secretary Paulson's potential plan is the section that states this act will not be reviewable or "reviewed by any court of law or any administrative agency."

CL: Again, it's not clear what this "act" is. I think this is more a concept than a plan at this stage. It does set up what would amount to a resolution czar, who would, in the Paulson concept, really have the ultimate authority to evaluate how we would be resolving the financial crisis. That seems to be something that Congress is pushing back on. Do we hand over to a single czar the ability to unwind this? In some ways that would be the most calming to financial markets, but on the other hand, it is also going to be the most repugnant to taxpayers and their representatives in Congress. Expediency, efficiency in some sense and confidence in the financial sector might be maximized by a czar who is very creditable; one could imagine Alan Greenspan being brought out of retirement to do this. [Laughs] On the other hand, you give that much authority and power to a single person, you lose the oversight, you lose the accountability, you lose transparency, which taxpayers and their representatives in Congress certainly have a right to expect.

DW: In your opinion, is this plan necessary? Is it necessary for the government to have such a large-scale intervention into our financial market?

CL: Probably. We are at this point where regulation (has) clearly failed so it's too late to lay blame and worry about that. The financial markets are probably on the verge and brink of collapse, and allowing the financial markets to collapse is probably imprudent and would not reflect sensible policy at this stage. So, yes, the need for government intervention to calm the market in some way, to help clean up balance sheets in financial sectors, is probably real and probably sensible.

DW: Are there any sort of obligations from foreign countries to help restore American economy?

CL: Oh, this is not an American problem, to be clear. This problem is probably equally deep and material in the United Kingdom. This is a global phenomenon. Global financial institutions are at stake here. Our intervention will almost certainly be matched by interventions of our partners, central banking institutions - certainly the Bank of England and the European Central Bank. As the saying goes, "If the United States sneezes, China catches a cold." Their emerging markets are entirely dependent on the United States and European markets. There is nowhere you can go to escape it, given the integrated nature of global finance. To be fair, however, I think the adverse consequences, certainly in the short term, will be concentrated in the United States.