THE PRODIGAL SONS: BIG BANKERS AND THE GREAT RECESSION

By Nick Gier

A certain creditor has two debtors; one owed five hundred denarii and the other fifty.
When they could not pay, he forgave them both. Now which of them will love him more?

—Jesus to Simon the Pharisee (Luke 7:36)

A woman of the city, who was a sinner:
“Therefore I tell you, her sins, which are many, are forgiven,
for she loved much; but he who is forgiven little, loves little.

—Jesus (Luke 7:47)

The Celtic Tiger cubs learned to spend ostentatiously because
"they were worth it," but the cubs must rediscover old-fashioned values.

—Brian O'Kelly, Dublin City University

The conservative Irish government finally admitted that it has a huge problem with its banks, and the European Union (EU) and the International Monetary Fund is prepared to bail them out at the tune of $140 billion. It is now clear that poorly regulated banks were the main cause of the Great Recession.

Banks in Iceland, Greece, and the Baltic States—all led by right-center governments—have failed, but they also got into trouble in some countries led by left-center coalitions. Social Democrats and Labor politicians in Spain and the UK were just as lax with regulation as their conservative counterparts. Spanish and Irish banks loaned freely and wildly for construction projects, which have now has left these workers high and dry after the bust.

Under a conservative party allied internationally with the GOP, Iceland privatized its banks and removed most regulations. With irrational exuberance the banks lent wildly in Europe and ran up debts that amount to 580 percent of GDP. In a recent referendum Icelanders rejected a plan to pay back billions of dollars that their banks owe thousands of European depositors. Just like the Irish, ordinary Icelanders see no reason that they have to pay for the crimes of their greedy bankers. See my column “When Good Fisherman Become Bad Bankers” at www.home.roadrunner.com/~nickgier/Iceland.htm.

The theory that American mortgage crisis was caused by bleeding-heart liberals who foisted subprime loans on poor people simply has no basis in fact. Financial giants such as Country-Wide were driven by profits not misguided compassion, especially now that we know that untrained and clueless employees have been signing foreclosure papers left and right.

Contrary to widespread misinformation, the Community Reinvestment Act (CRA) played no role in the subprime crisis. Writing for *Bloomberg Business News* (9/29/08), Aaron Pressman states that “this is even more ridiculous than blaming Freddie and Fannie.” Fannie and Freddie’s share of loans dropped to 3 percent in 2005 (from 11 percent in 1995) while private mortgage originations surged to almost 40 percent.

Nearly 80 percent of the subprime loans were made by private firms not subject to the CRA, and as former Fed Governor Ned Gramlich reminds us: “The majority of loans were made with very little supervision. It is like a city with a murder law, but no cops on the beat.” The Bush, Jr. administration made sure that “regulators” did not do their jobs.

For years free marketeers have praised the economic miracle of the "Celtic Tiger." Economic growth was indeed impressive: an average 6.4 percent from 1990-2007 with a peak of 9.5 percent in the late 1990s. Workers, especially those from Eastern Europe, poured into Ireland for good paying jobs.

America's Heritage Foundation and Cato Institute boasted that it was low corporate taxes that fueled the boom, but others argued that it was also large transfer payments from the EU that made the Celtic Tiger roar. As new EU members, Portugal, Spain, the Baltic States, and Greece also received massive aid from "Old Europe," prosperous economies built on social democratic principles over 60-80 years.

But in 2009 the big Irish party turned into a wake as the economy declined 7.5 percent, exceeded only by the Baltic States' Depression of 20 percent. The Irish budget deficit is now 32 percent of Gross Domestic Product (GDP), by far the EU's highest. Britain is at 10 percent followed by Spain at 9.6 percent. Greece has reduced its deficit to 7.9 percent, but the U.S. figure still stands at 9 percent. Even with debt-ridden Britain, Ireland, and Spain averaged in, the Euro area’s budget deficit is only 6.5 percent.

The Irish unemployment rate has climbed from 4 percent to 14 percent, second highest after Spain’s 20 percent. After the bust, young Irish workers are now resuming their traditional exodus to other countries for jobs. So far 27,700 have left this year alone, a 50 percent increase over 2009 (*The Washington Post* 11/23/10). The Union of Students of Ireland estimates that more than 50 percent of graduates will emigrate over the next five years.

Rich Blake of ABC News offered this diagnosis of the Irish crisis: "The banks overindulged during the past decade, lending hand over fist in a bubbly real estate market and leveraging balance sheets to the hilt." House prices have fallen as much as 70 percent and many Irish home owners are behind in their mortgages. Does this sound familiar?

Anglo Irish, the largest bank, was nationalized after it was found to have cooked its books and made billions of euros in bad loans. An Irish TARP-like fund was set up to save the other banks, and Finance Minister Brian Lenihan declared that at $45 billion it would be the “cheapest bailout in history and it would not cost the Irish taxpayer a penny.” He was at least $100 billion short in his estimate, and the Irish are furious.

The Irish government has combined tax increases and spending cuts to reduce the budget deficit. New taxes total $20.5 billion and the equivalent tax increase for the U.S. would be $1.4 trillion dollars. Britain’s new conservative government is also raising taxes—the national sales tax will go up to 20 percent and capital gains will increase to 28 percent—but will the GOP’s motto “No New Taxes” mean that the U.S. will never get its deficit under control?

The Tea Party folks convinced a great many Americans that it was bad policy to bail out the banks, AIG, GM, and Chrysler. But if Bush and Obama had not done so, the results would have been disastrous for the U.S. and the world economy, just as it would have been for Greece and Ireland. Ireland's finance minister now admits that "because of the huge risks our Irish banks took earlier this decade, they became a huge risk not only to this state but to the Eurozone as a whole."

Ireland would have ceased to exist as a functioning economy, directly affecting the 600 U.S. companies that have set shop there because of low corporate tax rates. As Laura Flanders states: "Every time we Google we're using a company that's avoiding taxes at home in the U.S. and shuttling profits in and almost tax-free out. The influx of temporary corporate cash creates a big bubble, but leaves no incentive for actual investment in Ireland" (*Huffington* Post 11/24/10).

The European Union has acted more quickly with Ireland than it did with Greece, and their dilatory action made the Greek bail-out much more expensive. The EU, however, is hobbled by the fact that, although 16 countries share the same currency, they constitute only a loose confederation with precious political unity.

There is a good reason why our founders discarded the Articles of Confederation, and why Congress agreed with Alexander Hamilton that the new federation government should assume the revolutionary war debt of all the states. The French were very happy to buy the bonds that were floated to pay off the debt. The Tea Partiers who hate the federal government and want to return all power to the states should learn a lesson from this.

All of this reminds me of the Parable of the Prodigal Son. The good sons are the Canadians and the Israelis whose boring but well regulated banks are sound. Good siblings are also the Swiss (0.4), the Swedes (1.5), the Poles (3.2), the Germans (3.7), the Hungarians (3.9), the Belgians (4.8), the Austrians (5.1), the Danes (5.2), the Dutch (5.7), and the Czech (5.8), whose governments have prudently kept their GDP deficits to the percentages cited.

A really innocent son was the first German bank to fail in 2007: a small state bank that did not realize the danger of the "sliced and diced" U.S. mortgage securities it had unwittingly purchased. The good sons also include many American community banks; many have failed but some have survived through wise management. North Dakota has now established a state equivalent of the Federal Reserve, which other states are eager to follow in order to protect their banks.

In contrast to the father of the Prodigal Son, the fatherly Congress, International Monetary Fund, and the European Central Bank did not bail out their profligate banks out of love and compassion; rather, they did it out of self-interest and the common welfare. Bush and Obama did not help banks and auto firms because they were socialists (Bush's initial decisions here make the charge even more ridiculous); rather, they consulted a wide range of economists and who said that it was the only way to save economy.

Unlike the "woman of the city," who loved much and was forgiven most, big bankers have lusted after quick buck and easy euro. The good sons and daughters of Europe very reluctantly have taken on the debt of their wayward brothers. Germany's Prime Minister Angela Merkel is a Christian Democrat, but it was economic realism not love that moved her to support the Greeks and now the Irish.

But will the wayward brothers really love their brothers and sisters because they were forgiven a debt of 500 hundred dinarii rather than 50? U.S. bank executives show no gratitude as they shamelessly rake in huge bonuses. The economic ethics of the Gospel doesn't appear to have much application to the current economic crisis.

And Jesus wept, and he is still lamenting the fact that people put consumer durables far above their deep moral and spiritual needs.

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