



HORSERADISH AND CAPITALISM

Sunday, May 2, 2010

Every week CUIP's president Jacqueline Salit and strategist/philosopher Fred Newman watch the political talk shows and discuss them. Here are excerpts from their dialogues compiled on Sunday, May 2, 2010 after watching selections from "The Charlie Rose Show" and "Hardball with Chris Matthews."

Salit: Fred, here's something that struck me in Charlie Rose's discussion about the battle over financial regulation. Charlie Rose asks his guests: 'What's the deal here? What's going on?' Evan Thomas says: 'This is an ancient story in American political life. It's the story of the anger of the outsiders at the privileges of the insiders. This happened in the 1890s and it happened in such and such time, etc. It's happening again and this is part of the ongoing cycle of American history.' The thing that struck me about the entire discussion about regulatory reform is that it was a discussion among insiders. You have financial journalists. You have the Wall Street guys. You have the government officials. And they all talk about the derivatives, the subprime mortgages and all that. They're putting the whole conversation on TV, because they put everything on TV now, about what Goldman Sachs did. So, the context, if you want to use that term, is the outsiders' anger at the insiders. But the outsider/insider tension isn't being addressed by the discussion about reform. You just have the insiders working on trying to fix up the system that belongs to them. I'm sure they'll come up with some approaches that will, for some time, mute the extreme excesses of investment banking. But it's not as if you have any sense that the outsider/insider caste system is being called into question.

Newman: I agree with you. What are you saying about it?

Salit: Maybe since everyone is giving their commentary on financial regulatory reform now, we'll give ours which amounts to this: On the heels of a very, very dangerous financial collapse – dangerous because of the systemic risk involved – you have a group of insiders tinkering with the system. It's a repair job by the people who are running the system. It has little or nothing to do with the outsiders.

Newman: I take it that the response to your point would be that you're leaving out the many different competing elements that are insiders, never mind the competing elements among the outsiders. It's not as if there's one person who is the insider and one person who is the outsider. There are lots of insiders – this is what they would say – and these multiple insiders are having a debate. By way of agreeing with you, the thing that will come out of this, hopefully, is that the good insiders will gain some advantage over the bad insiders.

Salit: Right.

Newman: That's American politics in a nutshell. Not everyone is an insider and not every insider is the same. That's essentially what you're saying, which is true. I think that's accurate. This is more exposed than ever before because it's on national TV. So one insider says, *You're a crooked insider*. The other insider says, *No, I'm not. In fact, you're a crooked insider*. And a third insider says, *No, you're both crooked insiders*. Then someone says, *Maybe everybody is crooked*. Part of that game is that some insiders are going to try to discredit other insiders, but then that could get out of hand. Maybe they'll get together to find a way to regulate how they look, more than what they do. They'll likely come up with a system to make them look less like they're taking advantage of being the insiders.

Salit: That's what you get for being an insider.

Newman: Yes. I don't know what they call you if you're an insider who doesn't take advantage of that position. Probably they call you "crazy" or something like that. That's why some people call this a dog and pony show. Who is there to give anything resembling an objective characterization of all this? The only people who are hip enough to what's going on are the players themselves. How do you get out of that bind?

Salit: Maybe this is the bind you're describing. They've had endless stories over the last week about what Goldman Sachs did. They sold one set of products that were the subprime mortgages, the derivatives thereof, and then they sold another set of products that were essentially bets that the subprime mortgage market would fail. So they had two sets of products, one of which makes money on one scenario and the other of which makes money on another scenario. And they're competing scenarios, arguably. So there's all this talk: *Oh my God. Look what Goldman Sachs did*. And the SEC has filed a complaint and so forth. Maybe they did something illegal and maybe they didn't. I presume that the appropriate bodies will review that and a million lawyer hours will be spent defending this. But then I think, didn't they just do what you do when you're an investment bank?

Newman: Which is?

Salit: Create products and take them to market.

Newman: Yes and no. So, for example, let's take a look at a dominant industry in the country today, the computer industry. The industry sells millions of computers and they continue to sell them even while their research department is developing the next line of computers, which are improved models which make the old computers, which they're making a fortune by selling...

Salit: ...obsolete.

Newman: ...obsolete. And they know all this information at the same time. Once upon a time the market was purer in the sense that the people who were making horseradish didn't simultaneously create a substitute for horseradish. The argument can be reduced to the idea that the old fashioned way was a more honest way. That's what these clowns in Washington are, in a basic sense, discovering. That capitalism has found a way to make, not only the kind of money it used to make 100 years ago, but it's discovered marketing techniques, together with the technology for implementing them, for doing this other kind of thing. And now they're raising questions about whether that's illegal or not. Arguably, the more accurate name for it might not be "illegal," but "progressive." It's a way of making more money. I'm just trying to introduce the notion that some people are still where they were 100 years ago. They're still pounding away on the grapes and producing a bottle of wine. That's how they make their money. But the mechanics of global capitalism have changed dramatically. And these people are questioning the morality of that. I don't know what to say about that. If the game is making money, what's the problem? That's the nature of the system.

Salit: Is there a difference between creating products and taking to market such products, as horseradish, and horseradish substitute, and a computer, and its next generation – on the one side – and the kinds of products that Goldman Sachs is selling which aren't real things in the sense that you can't put them on your gefilte fish? You can't send an email on them. They're fictitious instruments that are complex financial ownership formulas, or investment formulas, or bets that are many, many, many, many, many steps removed from "things." Maybe it's the case that in our society, in 2010, given the nature of globalism, capitalism, technology, etc. that they are no less "things" than horseradish. They're a kind of thing that exists and can be marketed and sold.

Newman: That's true. They're commodities.

Salit: They're commodities like any other commodity. But there seems to be in the dialogue – and we're going back to the finger-pointing thing – at least an element of the argument that says, *Not only did Goldman Sachs sell the thing and its opposite, but the thing isn't even really a thing. It's a derivative. It's doesn't represent any real value.* Supposedly that makes the "crime," whether it's a legal crime or an ethical crime, all the more heinous.

Newman: I don't quite understand it that way. I think they're saying something different.

Salit: What do you think they're saying?

Newman: I think they're saying that the "crime" lies in the fact that you're selling A to somebody and trying to make as much money as possible – I'm going back to my computer model – but you have something in the garage which is an inch away from

replacing A and you don't tell that person who you sold the original thing to...which, if you were giving full information...

Salit: ...might cause the person not to buy the first thing and wait for the second thing.

Newman: Yes. And so you shouldn't use the profit you gain from selling A to complete your work on its replacement. I think that's what they're suggesting is criminal, more than all that stuff about commodities. Maybe they are raising that, but that seems to me to be too generic to be raised.

Salit: This analogy that you're suggesting about the old style computer and the newer style computer is really a fascinating way of looking at this scandal. If Goldman were smart, they would introduce that as part of their defense. They'd say: *Look. We invested in the subprime mortgage derivatives. We sold them heavily. And some of our people said, "You know what's going to come next? The bubble's going to burst and the value on those derivatives is going to drop very significantly." So here's a next product which comes down the line which is better than the old product because it says that all this investment in subprime mortgages is faulty. That market is not going to sustain itself indefinitely for all the reasons that it won't. Here's a new product. We wouldn't have thought of this product before...*

Newman: Except – now I'm switching, in a way, to the other side. The potential problems with B, the new product, happen in part because of the way we're dealing with the sale of A. Those who buy product A may be getting screwed. But I don't even find that so unusual. It seems to me that an honest capitalist would say in response to me pointing that out: *Well, buy it if you want it. If you don't want it, don't buy it. We're out to screw you. But that goes without saying. If you think that that's not morally right, or legally right, then why don't you go back to basics and discuss the moral value or worth of profit altogether?* Profit is the reward because some people take the risk. So, yes, in the old days when you sold the horseradish, your risk was limited, presumably. And so was your profit. You're always trying to compensate for the potential risk – the capitalist is – by having a situation that is as controlled as possible. All they're really saying here is that Wall Street went a little beyond the pale.

Salit: There's part of me that thinks, going back to this insider/outsider thing we were talking about at the top, if we could organize all the American people to have a say in this process, what the American people would say is: *All right, look, you guys go work all this out. Here's what we want. We want to have 30% of all of the profits that you guys make off of these transactions, however you decide to regulate this thing, to go into free quality education for everyone in America through college and a guarantee that every home has clean water and every family has enough food to eat. Whatever you guys want to do, you should do. You want to make selling derivatives illegal between 6 pm and 8 pm on the West coast? It's your industry. You know the ins and outs. You go do it. But here's what we need.*

Newman: And the Tea Party will shout: *That's socialism*. And they'd be right. *Why should the people who are better at making money – they would say – contribute more money for the public need? Why shouldn't everybody pay something proportional to how much they use publicly-funded facilities?* I agree with what you are saying, but then again, I'm a socialist. But I think there are arguments against it. If you're motivating people to make the most money, because that's what pushes the GNP up and that's good for the country, then why would you create disincentives? What's the morality behind that? As long as you have a capitalist system which urges people to make as much money as possible, why would there be, in some sense, a penalty for doing that?

Salit: Well, it turns on the relative value you place on social good.

Newman: But, there is a basic moral confusion built into the whole system around that and yet, the system, it is argued, is the most productive, most innovative, in the history of the world. The argument that aggressive Wall Street derivatives trading crosses the line into illegality has to answer to the counter argument that what you're going to do is stop American growth. Presumably, there is a proper amount of profit, if you could ever identify it mathematically, that would be optimal for economic growth.

Salit: That's socialism. It's called a planned economy.

Newman: That's socialism, because that's not letting the market do its work. In fact, the closest approximation that we have for establishing that point is the market. Anytime you interfere with the market, it's not clear that what you're introducing would properly substitute for the market.

This is how I try to understand these things, in the midst of all the additional bullshit that's going on. For me, for my simple-minded head, this is a basic way of understanding what these guys are talking about, and what's going on. I'm not convinced that it's resolvable within the framework in which it's being discussed. That said, will they resolve it? Yes, probably. They'll make some relatively arbitrary compromises that will resolve it and we'll go on. Meanwhile, there's all the politicking that's done, which is where the real differences lie. But those differences won't be discussed in a language which is comprehensible to everybody.

Salit: Not this time around. Thanks, Fred.