

CENTRAL BANKS

Damned if They Do; Damned if They Don't

by John Hoefle

When the banking crisis broke out into the open last year, and the central banks embarked on a regime of liquidity pumping, collateral sucking, and bailouts, Lyndon LaRouche warned that this would inevitably lead to hyperinflation, and that it must be stopped, immediately. Yet, the bankers kept going, insisting that the problem could be contained with quick action, even as the “subprime crisis” grew into a “credit crisis,” and finally revealed itself as what it had been all along, a full-fledged systemic financial crisis centered in the big banks.

Since last year, the major central banks of the Anglo-Dutch Liberal system, led by the Federal Reserve and the European Central Bank (ECB), have issued some \$3.5 trillion in loans to the banking system, much of that in exchange for “illiquid” collateral—illiquid being a polite way of saying worthless. This debt-recycling scheme has, at least temporarily, taken some of the huge quantities of worthless paper off the banks' books, making the banks look a little less bankrupt; but the bailout program has, as LaRouche warned, been an unmitigated disaster, spreading hyperinflation from the financial markets into the prices of everyday essentials such as food and oil, raising the cost of nearly everything our households need to survive.

Without this extraordinary bailout operation, the financial system would cease to exist. The banks would have to close their doors, and quadrillions of dollars of fictitious assets and derivatives bets would have to be written off, wiping out all the so-called profits of the past four decades, revealing the post-industrial financial boom for what it was: a fraud. As true as it is, it is not a conclusion the bankers are willing to accept voluntarily.

However, the soaring prices of food and gas create a

whole different set of problems for our economy, and a different set of problems for the banks. Our economy, we have been repeatedly told, is driven by consumer spending, but the more consumers are forced to spend for food and gasoline and other essentials, the less they have to purchase other goods, like new cars, furniture, electronic gadgets, movies, and the like. It also means they have less left over to service their credit card and other debts. The corporations which make, import, and sell these goods and services are hit with a combination of increased costs as the prices they pay rise, and decreased profits as their sales fall. The receding tide of economic activity lowers all boats.

Furthermore, the nation is overloaded with debt—personal debt, household debt, corporate debt, and financial sector debt—which, as a whole, cannot be paid. We have dealt with this in the past by rolling it over, issuing new debt to pay off the old, with the total growing all the while. The banks made room for the new debt by selling the old into the asset-backed and “structured finance” securities markets, where these sows' ears were seemingly turned into silk purses. These markets have since virtually shut down, and with them the mechanism for rolling over the debt. As a result, the debt crisis is again taking center stage.

The central banks are thus faced with a dilemma: If they stop the bailouts, the whole house of cards will come tumbling down; but if they keep the bailout going, the hyperinflation will blow out the financial system, the dollar, governments, households, and what's left of the economy.

They are damned if they do, and damned if they don't.

Faction Fights

This is what is behind all the discussions of interest rate

hikes at the ECB and the Fed, and the recent statements by central banker emeriti like Paul Volcker. The realization is growing among many in the financial community that the bailout policy is a disaster, and that the liquidity pumping must be constrained. This is a form of financial triage, in which parts of the system are left to die in the hope of saving the system itself. Naturally, those being left to die are opposed to the plan, and the whole issue of which parts will be left to die is fraught with contention. When it comes to sacrificial lambs, there are no volunteers.

Volcker, the former Fed chairman, who now chairs the Group of 30 “wise men” organization of senior financial figures (the Bank of England’s Mervyn King and the ECB’s Jean Claude Trichet are also members), told the International Economic Forum of the Americas in Montreal on June 9, that the current financial system has failed the test of the marketplace.

“I suspect the apparent need for intensive and broad reform will be reinforced in the coming months by further financial pressures, pressures likely to arise from the slowing U.S. economy and the possibility of recessionary tendencies,” Volcker said, calling on the Fed to exercise “disciplined monetary management” to keep inflation under control. Volcker called the turmoil of the past year a “clarion call,” which exposed weaknesses in the regulation of the derivatives markets and non-bank financial institutions.

LaRouche characterized Volcker’s comments as useful and valid warnings, but insufficient. If Volcker wants to be taken seriously, LaRouche said, he must come to grips with his own role in setting the financial bubble into motion, and admit his own mistakes. This is a time for honesty, not passing the buck.

New York Fed CEO Timothy Geithner, addressing the Economic Club of New York on the same day as Volcker’s speech, opened with a discussion of the “fragile” condition of the financial system, and though he, like Volcker, spoke in sanitized terms, his audience well understood the gravity of the situation. He described the rise and fall of the securities markets, noting that when they collapsed, “banks could not fully absorb and offset the effects of the pullback in investor participation—or the ‘run’—on this non-bank system, in part because they themselves had sponsored many of these off-balance-sheet vehicles.... Banks lost the capacity to move riskier assets off their balance sheets.”

While Geithner’s descriptions call to mind the way in which the proverbial boy on trial for murdering his parents asked for sympathy because he was now an orphan, the crisis to which he alluded is real and, as he admits, must be resolved. However, he rules out the only real solution—putting the system through bankruptcy—by insisting we “first repair, then reform” the system.

“Our first and most immediate priority remains to help the economy and the financial system get through this crisis,” Geithner said.

Two Tiers

The problem with that approach is that saving the economy requires putting the financial system down, and taking the money we are currently throwing down the bailout rat-hole and spending it on rebuilding the nation’s productivity. Remove the parasite first, then heal the host.

To do this will require a huge dose of low-interest-rate government credit to fund large-scale development projects like nuclear power plants, high-speed maglev trains, water projects like NAWAPA (North American Water and Power Alliance), in addition to rebuilding our roads and bridges, water and sewer systems, schools, and such. We must also launch, as a top national priority, the development of nuclear fusion as a power source, and the development of technologies to allow us to use hydrogen as a fuel. This must be done on an emergency basis, both to rebuild our standard of living and reduce our dependence upon the oligarchic raw materials cartels, beginning with oil. We can, and must, think our way out of this crisis.

What is needed, as LaRouche has said, is a two-tiered credit system, in which credit is made available for such projects at very low interest rates—one to two percent—while charging higher rates for other purposes. Money, even in large quantities, issued for these productive projects is not inflationary, since the increases in productivity, and resultant economic growth, these projects would generate would cover the costs many times over.

Our Only Hope

LaRouche’s three-point plan is our only hope at this late hour. That plan begins with the passage of the Homeowners and Bank Protection Act (HBPA) to put up firewalls to protect the citizenry, while the financial system is put through bankruptcy, which is a prerequisite for point two—the introduction of the two-tiered credit system. Then, having corrected our own mistakes, we can begin working with other nations—Russia, China, India, and others—to rebuild the world under American System principles, as we did in the beginning, and again, in the post-Civil War era. We must abandon the British imperial methods we have adopted in recent decades, and return to the most powerful economic system the world has ever seen: the American System.

The great irony here, is that the attempt to save the current, Anglo-Dutch Liberal system, to preserve the fictitious riches some among us have amassed, is what dooms us, while letting the fiction go and returning to the American System would open the door to prosperity for all. Faced with more heads than hats, the oligarchs choose to lop off heads, but it were far more humane and productive that we simply make more hats.

We should be considerably more concerned about the fate of humanity, the fate of our children, and the children of the world, than we are about the fate of a few rapacious banks and cartels, and the preservation of oligarchic power. It is time to let the illusions go, roll up our sleeves, and get to work.