Flipping and Flopping

The once-tough line of the central banks has turned to mush, as the reality of bankruptcy sets in.

Back before the global financial system blew out this Summer, the central banks and the Bank for International Settlements were talking tough about the need to rein in monetary policy. Now look at them, acting like a bunch of scared rabbits, offering not only to pour money on the flames, but also to take in worthless paper as collateral—all to avoid having to admit that they, their system, the whole global shebang, is hopelessly bankrupt.

At the first sign of trouble this Summer, they flipped into bailout mode, and they've been flopping around like fish out of water ever since. It would be laugh-out-loud funny, if it weren't so serious.

The Federal Reserve announced Dec. 12 that it had reached an agreement with the Bank of England, the European Central Bank, the Bank of Canada, and the Swiss National Bank on "measures designed to address elevated pressures in short-term funding markets." That is, to give them credit, a polite way of admitting that the banking system is bankrupt, and the spigots are being cranked wide open.

The Fed said it would inject the new funds "through a broader range of counterparties and against a broader range of collateral" than it could through its open market operations, to "help promote the efficient dissemination of liquidity when the unsecured interbank markets are under stress." The five central banks are expected to provide more than $100 billion this month.

Most of the reactions on Wall Street were typical of addicts being told that crack cocaine was going on sale, but there were some more sober responses. The action "smacks of a real fear that the world's financial system is in trouble," said *New York Times* columnist Floyd Norris, who added that, in plain English, the Fed was saying it will accept "almost any asset" the banks own, including the most illiquid and exotic in their portfolios. "This move is taken as evidence that central banks are determined to rescue the system, whatever it takes."

Just the day before, Martin Wolf had written in the *Financial Times* that the financial markets and the world economy were at a "turning point," with events delivering "a huge blow to the credibility of the Anglo-Saxon model of transactions-oriented financial capitalism," and "calling into question the workability of securitized lending."

Both Norris and Wolf are correct as far as they go. The transactions model and securitization go hand in hand, as key elements of the shift from a production-oriented society into a speculation-oriented one. Securitization provided the mechanism to turn the growing pools of debts into assets, which in turn allowed the rise of the traders on Wall Street, and the creation of the alphabet soup of ABS, MBS, CDO, CLO, ABCP, SIV, and other disasters. This "Anglo-Saxon" monstrosity has now blown up.

The coordinated move by the central banks and bankers (who are increasingly beginning to resemble the Keystone Cops) is but the latest in a series of rescue plans, all of which have gone awry. Treasury Secretary Hank Paulson's MLEC Super SIV plan has reportedly been downsized to $30 billion from its original $80-$100 billion, before it even got off the ground, and his so-called housing rescue plan is nothing more than a thinly veiled attempt to stabilize the mess of mortgage-backed and mortgage-related securities. To the bankers, houses are just an excuse to sell a mortgage.

What the banks and their alleged regulators are trying to do is to preserve the illusion of solvency by preserving the fictitious values of trillions of dollars of worthless securities they carry on their books as assets. That means they have to stop these securities from being sold on the open market, because such sales would establish market prices well below their fictitious book values, triggering waves of write-downs, which would in turn require further sales, in a deadly downward spiral.

What the bankers are doing is more political than financial. They know—or at least the more intelligent and less dogmatic among them know—that the largest financial bubble in history is now gone, and the fight is over what comes next. The actions they are taking can at best hide their losses a little while longer, and buy some time to put a new system in place. They might not be able to save all their money, but they are determined to save their power. Still, they are dinosaurs whose time has passed. They have failed, their economic model has failed, they have brought this nation and the world to the brink of collapse into a new dark age.

As Franklin Roosevelt once remarked, "the only thing we have to fear is fear itself," so let us rebuild the damage caused by this insanity, beginning with the passage of LaRouche's Homeowners and Bank Protection Act. It's a good first step.