Beating the Drum For a Banking Bailout

by John Hoefle

"We're looking not at a depression, we're not looking at a mortgage crisis: We're looking at a dark age," Lyndon LaRouche told a conference in Munich, Germany, on Feb. 13. Since the 1971-72 period, when the fixed-exchange-rate system was shut down, "the world has been building up a bomb, a giant bomb over a period of about two generations." Since then, LaRouche said, the United States was transformed from a great agro-industrial power, into a junk heap, unable to meet the needs of its own existence.

Under the oligarchic dogma called globalization, the U.S.A. has dismantled the productive power of its economy, shipping much of it overseas to nations where wages are low, and a similar process has occurred in the economies of Western Europe. The result is that the nations of the West have plunged into severe economic decline, and have attempted to make up for it through financial speculation and the accumulation of vast quantities of debt.

The great irony is that we have more money than ever, but we are still broke, because the financial assets we considered valuable have lost their value, and the attempts to prop them up are causing our money to lose its value at an accelerating rate. Despite the prodigious amounts of money produced by the financial markets, the productive potential of the global economy is collapsing. We have now reached the point where the attempts to solve this crisis by throwing more money at it, will trigger a devastating hyperinflation which will wipe out everything in its path. Nations will be destroyed, populations will be destroyed, if we continue down this path, LaRouche warned. Rather than continue our foolish attempts to bail out this system, LaRouche said, we must put it through bankruptcy proceedings, to save what we can and begin rebuilding the physical economy and vital services. To continue with these policies which are destroying us, would be insane.

Two days later, Feb. 15, Treasury Secretary Henry Paulson, Federal Reserve chairman Ben Bernanke, and Securities and Exchange commissioner Chris Cox appeared before the Senate Banking Committee, to call for a bailout of the system.

Save the Paper

The underlying theme of the testimony of these three members of the President's Working Group on Financial Markets (a.k.a., the "Plunge Protection Team") is that the problem with the U.S. economy is a "housing crisis," and that by cleaning up the subprime mortgage mess we can restore ourselves to health. Paulson expressed this view clearly, saying that the economy "is fundamentally strong," but "undergoing a significant and necessary housing correction."

By presenting the problem as a housing crisis, Paulson was able to push programs which have the intended effect of stabilizing the markets for mortgage debt and the securities which are (nominally) based on that debt, namely, trillions of dollars of mortgage-backed securities, collateralized debt obligations (CDOs), and other alphabet-soup speculative paper. These plans, from his "HOPE NOW" scheme to his plans to "modernize" the Federal Housing Administration (FHA), all revolve around supporting the existing debt.

Bernanke said much the same, stating that "investor concerns about the credit quality of mortgages, especially subprime mortgages . . . triggered the financial turmoil." Bernanke did address the problems of the banking system, but presented these problems as a result of "the sharp reduction in investor willingness to buy securitized credits," which he, of course, blamed on the housing crisis. The Fed, he said, has addressed these developments in two ways, by pumping money into the banking system through the creation of a term auction facility (TAF), and by lowering interest rates.

Cox, as expected, opened his testimony with a discussion of how financial markets worldwide "have been roiled by the deterioration of credit and liquidity conditions in the U.S. residential mortgage market, especially the subprime portion of that market." Cox focussed much of his attention on "the roll of the ratings agencies in the subprime market turmoil," citing the widespread public criticism of the accuracy of their ratings.

Senate Banking Committee chairman Chris Dodd (D-Conn.) also got into the act, characterizing the current economic situation as "a crisis of confidence among consumers and investors. Consumers are fearful of borrowing and spending. Investors are fearful of lending. Financial transactions which generate new businesses and new jobs are shrinking in number and size.... Our economy is clearly in trouble. The most important thing we can do right now is act to restore consumer and investor confidence."

The picture painted by all four of these supposed leaders is of the need to do whatever we must to restore the markets to their former glory, ignoring completely that the system they are so intent on restoring, has destroyed our nation.

Hidden Agenda

These men are not as stupid as they appear to be. Paulson, a former head of Goldman Sachs, knows all too well that the problem goes far beyond the mortgage markets, and that the idea that this is a housing crisis was part of a marketing strategy to sell the public on the need for a Federal bailout of the banking system.

As *EIR* has explained repeatedly, the explanations being given about the origin of this financial crisis are backwards, in that it was the bankruptcy of the financial system which drove housing prices into the stratosphere, as a way of creating artificial wealth, which could then be turned into assets with which to speculate. It was the need to feed this global pyramid scheme which led to the lowering of lending standards, and the creation of the mortgage-backed securities, collateralized debt obligations, structured investment vehicles, and other abominations with which we have become so familiar over the past year. It is the collapse of the financial system itself, which triggered the mortgage crisis, the rash of home foreclosures, the collapse of the securitization machine—these are not causes, but effects, of that systemic collapse.

Now, as the banking system itself seizes up, we are beginning to hear calls for a bailout of the banks, and we see what Paulson, Bernanke, and the Plunge Protection Team are really doing. They are organizing a bailout, but as public officials, they cannot say so directly, so the calls have to come from the private sector.

We reported last week on the plan advanced by New York banker and real estate man Howard Milstein, which appeared as an op-ed in the Feb. 6 edition of the *New York Times.* Milstein called for the government to explicitly guarantee all subprime mortgages, thereby eliminating the huge losses the banks have incurred on subprime-related securities. Other plans are also surfacing.

"The banking industry, struggling to contain the fallout from the mortgage debacle, is urgently shopping proposals to Congress and the Bush administration that could shift some of the risk for troubled loans to the Federal government," the *Wall Street Journal* reported Feb. 14. Credit Suisse, the big Swiss bank, is circulating a proposal to have the FHA guarantee mortgage refinancings by delinquent borrowers, with the government absorbing the loss if the borrowers default. "The fact that the plan is receiving serious consideration suggests the level of concern in Washington," the *Journal* said. JP Morgan Chase is also working on a plan to expand the use of FHA financing as a way of bailing out the banking system.

There are also plans under discussion to bail out the bond insurance market, the so-called monoline insurers. New York State is looking at ways to arrange for private capital infusions into the monolines, and the House of Representatives is considering creating a new Federal insurance program for bonds, according to Paul Kanjorski, the Pennsylvania Democrat who heads the House Financial Services subcommittee on capital markets.

It Won't Work

Not only will these crazy bailout plans not work, but they will backfire spectacularly, because they address the wrong problem with the worst possible solution. The problem facing the economy is not a "credit crunch" which can be solved with more money—the problem is the huge overhang of debt which is strangling us all, and a debt crisis cannot be solved with the creation of more debt. That is, after all, what Paulson and Bernanke are proposing, what Milstein, Credit Suisse, JP Morgan Chase and Rep. Kanjorski are proposing. They all want the government to step in and guarantee assets of the financial market, turning worthless private debts into government-guaranteed debts. What they would do, to use LaRouche's metaphor, is make the bomb even bigger, and push the economy into Weimar-style hyperinflation.

These schemes are not solutions, but desperate attempts to buy time, to postpone the inevitable collapse of the banking system. They are comparable to the actions of a gambling addict on a losing streak, who doubles down his bets in the vain hope of saving the day, rather than having the sense to cut his losses and walk away from the casino. We said before that these men are not as stupid as they appear to be, but that does not make their actions rational.

Gentlemen, it is time to quit acting on your impulses and begin to use your higher faculties. Your system is dead, and your attempts to save your virtual money will only make matters worse, far worse than you seem to understand. Do us all a favor and come to your senses, and please do it quickly.