Failed Bailout Ploy Heading Into Desperate New Phase

by John Hoefle

Jan. 16—The sudden bailout of Bank of America today, and the renewed talk of the need to buy hundreds of billions of dollars of bad assets from the banks, shows that the bailout process is entering a desperate and dangerous new phase. All the official verbiage aside, the bailout shows that not just Bank of America, but the banking system itself, is bankrupt, despite the trillions of dollars our government has thrown down the bailout rathole.

That point is underscored by the sudden emergence, in Washington, in London, and in the corridors of the Organization for Economic Co-operation and Development (OECD), of view that "toxic waste" must be removed from the books of the banks, so that the global economy can begin to return to normal. Once we relieve the banks of all these bad assets, the bailers claim, our system will recover.

The process is akin to the actions of a junkie, who knows in the deep recesses of his mind that he must quit, but hasn't the courage to do so. "One more fix," he says. "Let me feel better for a while, and then I'll stop." He never does, until it kills him. We are now at the point where the money junkies are unable to control themselves, and saner minds must intervene. It is time to stop feeding the junkies' habit, and put their system through bankruptcy. Before it kills us, too.

Bank(rupt) of America

Bank of America was one of banking's seeming great success stories, rising from a small bank in Charlotte, N.C., to become one of the largest banks in the world. Along the way it gobbled up banks in the South and Texas, changing from North Carolina National Bank to NationsBank, and finally, with the acquisition of San Francisco's Bank of America, NationsBank became Bank of America. In January 2008, it reached an agreement to buy troubled mortgage lender Countrywide Financial for $4 billion, after having pumped $2 billion into the bank in August 2007. The Countrywide acquisition was not a business decision in the ordinary sense, but a government-supported merger designed to prevent Countrywide from failing. The hope was that saving Countrywide would contain the damage, but it didn't work. Then, in September 2008, on the weekend that Lehman Brothers failed and AIG collapsed, Bank of America was again called on, this time to rescue Merrill Lynch. Blinded by its own ambition and lack of sense, Bank of America made the deal. It was, as the old saying goes, a bridge too far.

While Countrywide and Merrill Lynch were certainly major contributors to Bank of America's de facto demise, its actions with regard to these institutions were but the latest of the bank's missteps. Having grown like a weed during the boom times, the bank was vastly overextended and ill-prepared for a downturn. The Countrywide and Merrill Lynch deals were as much attempts to save Bank of America as they were to save the banks being bought. All of them were weak, and that weakness has now been revealed. The idea that Merrill

Lynch was to blame for Bank of America's demise is a cover story designed to hide the ugly truth about the U.S. banking system: the fact that both the system itself and the banks in it, are bankrupt. Where Citigroup went in November and Bank of America went today, J.P. Morgan Chase and Wells Fargo are bound to follow.

'Bad' Banks

The attempt to head off this meltdown is behind the talk breaking out around the world. Fed chairman Ben Bernanke, in a speech at the London School of Economics Jan. 13, raised the idea of having Treasury remove troubled assets from the balance sheets of financial institutions, through either direct purchases, asset guarantees, or the creation of "bad banks." Treasury Secretary Henry Paulson has made similar comments.

Bernanke was in London to meet with his central banking counterparts from around the world, and with British Prime Minister Gordon Brown. Britain, which has already injected hundreds of billions of dollars into its banking system, is now planning on setting up a "toxic bank" of its own, to buy, initially, tens of billions of dollars of bad assets.

This same theme was echoed by the OECD, which issued a report on Jan. 12 citing the need to remove toxic waste from the banks, so that a recovery could occur. The Paris-based OECD has 30 members, including most of the nations of Europe, plus the United States, Canada, and Australia.

The OECD is correct that the toxic waste must be removed, but the real question is the manner in which that is done. Here, the choices essentially boil down to two: 1) have the governments buy that waste, and the game continues; or 2) put the system through bankruptcy and write off the bookkeeping valuations of that waste in an orderly way. The first approach is folly, and it will never work anyway, because having the governments buy the paper merely moves the unpayable claims from the books of the banks to the books of the governments, bankrupting the nations. The second approach, the bankruptcy reorganization advocated by Lyndon LaRouche, begins with the understanding that most of this paper is worthless and must be written off, in a manner that protects both the citizens and the essential components of the banking system.

In his London speech, Bernanke seemed quietly hysterical, alternately praising the actions taken so far, while admitting that the situation continues to get worse. He detailed the series of interest rate cuts made by the Fed, and outlined the still-expanding list of new lending programs the Fed, Treasury, and FDIC have enacted, going so far as to claim that these actions "likely prevented a global financial meltdown in the Fall."

Despite all that success, and the trillions of dollars spent so far, Bernanke admitted that "more capital injections and guarantees may become necessary to ensure stability and the normalization of credit markets." It is in that context that he mentioned the bad banks.

Bernanke's comments were hardly encouraging. Every step he has taken so far has failed to solve the problem, yet he continues to do the same thing over and over, on an ever-increasing scale. For the proclaimed leading expert on the Great Depression, it is hardly an inspiring performance. Still, what more could one expect from a disciple of Milton Friedman? Economics is not exactly a strong point of the vaunted Chicago School.

Can't Go Back

The dead-end nature of the current regime was expressed by the Group of Thirty (G-30), a "wise men"-style body comprised of prominent former central bankers, regulators, and academics. The G-30 just released a study, conducted under the auspices of former Fed chairman Paul Volcker, which laid out a series of regulatory reforms designed to restore some semblance of sanity to the regulatory environment, and to dry up some of the excesses which have characterized the recent period. Some of these recommendations are in the right direction, but the plan as a whole has a serious flaw: it assumes that merely returning to where we were before the bankers went bonkers is both possible and sufficient, whereas it is neither.

The report amounts to re-regulating the barn door after the horse has died. The financial system has already died, and no amount of tweaking the regulations will bring it back. It is no longer possible to merely clean up the mess within the financial system.

What must be done, as LaRouche has repeatedly insisted, is to put the entire global financial system—the Anglo-Dutch Liberal central banking/monetary system—into bankruptcy. The quadrillion-dollar global derivatives market must be shut down, and the remaining hundreds of trillions of dollars of financial claims and assets must be frozen, pending an orderly workout. The existing system cannot be fixed, it must be replaced.

johnhoefle@larouchepub.com