Banks and Real Economy in Free Fall: Will Obama Become the New Roosevelt?

by Helga Zepp-LaRouche

When Barack Obama takes his oath of office as the new U.S. President on Jan. 20, we will in any case be in a completely new strategic situation: The nightmare of 12 years of various Bush Administrations, is over. But the speed with which the world economy is disintegrating is so breathtaking, that if a descent into total chaos is to be avoided, the new President will have to waste no time before issuing a clarion call demonstrating his readiness to take the lead in creating a new global financial system.

Very soon, we will see whether Obama has the wherewithal to tread in the footsteps of Roosevelt, who, in 1933, with his New Deal, began to powerfully lead the United States out of the Depression. One opportunity for Obama will be the fact that at least some members of the Group of Thirty—a group of economists and former central bankers who will advise the future President—have realized that all the innovations introduced into the financial markets since Alan Greenspan was installed as Federal Reserve chairman in 1987, are what have led us into the present disaster; and they believe that changes are urgently necessary.

But the job will not get done with small corrective measures, "new rules," "transparency," etc. If the new Administration is to seize this opportunity, it must revive the idea, anchored in the U.S. Constitution, that the government is acting with the legal authority to protect the nation and its people against private interests' improper or criminal encroachments. In this crisis—the greatest crisis in the history of financial markets—the issue isn't money, but rather whether, with the aid of natural law and the principles of the Peace of Westphalia, the inalienable rights of all citizens can be upheld, as they are guaranteed by the U.S. Declaration of Independence.

This means that the full program which Franklin Roosevelt envisioned with the New Deal and the Bretton Woods system, up to his death, must now be put into place. The new system must implement Roosevelt's intention of conquering colonialism and abolishing it from the planet forever—an intention which was annulled by his Anglophile successor Truman.

This, in turn, means that not only must the U.S. banking system be put through a full bankruptcy reorganization, but that the present monetary system must be replaced with a credit system, as it is defined in the U.S. Constitution. And it also means that the new Administration must take the lead in solving the international crisis, and that the new system must bring justice for all the world's nations.

One positive factor in this situation, is the fact that Lyndon LaRouche's authority and credibility, and the undeniable correctness of his forecasts of the now-unfolding systemic crisis, have grown enormously—emphatically so in the United States itself. LaRouche's proposed solutions are therefore now playing an absolutely essential role in the ongoing debate within and around the new Administration. And a very short time will tell whether LaRouche's proposals will be adopted in practice.

Collapse Grips the Real Economy

On the other hand, the fact that none of the bailout packages, or the various discussions about creating "bad banks," or every conceivable kind of economic stimulus program, has had any effect whatsoever, was forcefully demonstrated anew by the Berlin government's release of its second economic program. While Chancellor Angela Merkel and other members of the Grand Coalition government were at the Bundestag debate defending their Eur50 billion program, consisting of a grab-bag of some useful and some less reasonable measures, on that same day the stock value of various banks and firms went into a nosedive. After Deutsche Bank reported a sizeable Eur4.8 billion loss for the Fourth Quarter of 2008, the Postbank's stock collapsed by 17% on each of two successive days—an obvious reaction to the news that Deutsche Bank is going to buy Postbank, through its investors—while Commerzbank's stock lost 10.7%, and Hypo Real Estate 5%.

Figures for the German machine-tool sector in November were also just released. Orders in that month dropped by 30%, and the drop was even greater for textile machines, the construction sector, and for printing presses, which were down 50% and more. U.S. banks also continued their downward spiral: Citicorp reported $8.29 billion losses for the Fourth Quarter, and the U.S. Treasury declared its readiness to give Bank of America $138 billion (!) to shore up its bad assets.

A glance at other categories around the globe shows that banks and economies alike are in free fall. California's Gov. Arnold Schwarzenegger has declared a financial state of emergency, and announced that over 2,000 public construction projects are now suspended. Texas has announced a $9 billion budget deficit; Massachusetts, Michigan, Nevada, and Maryland are likewise reporting massive deficits; the combined deficit for all U.S. states is at least $200 billion for this year and next. Figures for retail trade in December dropped into the basement, sales figures for new construction and the corresponding number of construction jobs fell, and and there was a massive collapse in commercial real estate. The amount of unserviceable credit card debt, student loans, and auto loans rose as well.

After the S&P rating agency devalued Greece's foreign debt, this deeply indebted country encountered problems selling even short-term (i.e., three-month) notes. Rumors are circulating that a good number of countries are now insolvent. The decline in orders for machines in Japan in December, when annualized, was 71%! The Baltic Dry Index, which reflects shipping costs for bulk goods such as iron ore and grain, but also for manufactured goods, collapsed by 96%. Korea's exports declined by 30% in January, while Taiwan's and Japan's exports were down 42% and 27%, respectively. And in a somewhat different but related category: The U.S. Joint Forces Command released a report warning of massive security problems as a result of the rapid and sudden collapse of Pakistan and Mexico.

Bailouts and Stimulus Packages Fail

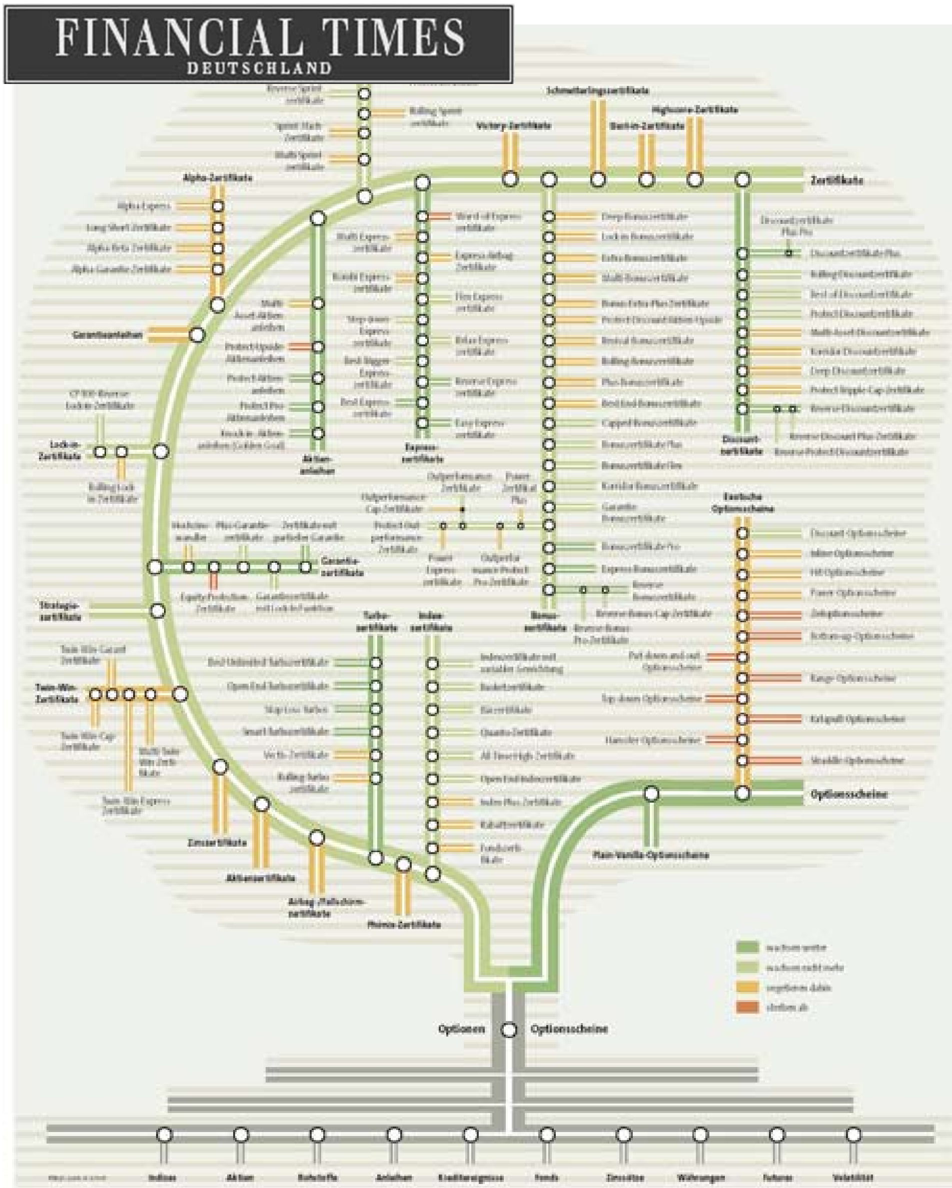
Ever since August 2007, governments and central banks have been making "bailout packages" available on the order of trillions of euros (!) for banks and economic pump-priming. And what good has it done? Absolutely none: The worldwide collapse has continued unabated. The reason for this is much simpler than the various "experts" and "analysts" would have us believe: As long as the banks' toxic waste—i.e., their ultimately unsellable derivatives paper—continues to be honored on the banks' balance sheets, the credit crunch and the crisis of confidence will continue. It makes no difference how many new packages are "bundled and finalized." The banks know from each other how big this problem is, and therefore they are taking money from the government—that is, from the taxpayers—but they are not passing the money on.

This is why governments everywhere are now working on the idea of using newly created "bad banks" to take over these hundreds of billions in toxic financial wastepaper. From Josef Ackermann of Deutsche Bank, to British Prime Minister Gordon Brown, to the U.S. Treasury Department, people are considering how to relocate these "ticking time-bombs," so that banks will be able to resume normal activities. The only problem is that this paper is extremely complex and nontransparent, precisely because the derivatives market has long been completely self-contained, such that this paper has been continually rebundled and resold as new packages.

Garbage In, Garbage Out

What price should be put on all this toxic waste? If the price is set too low, the banks may refuse to sell it to the "bad bank," because then they might have to make unsustainable write-offs; if, on the other hand, the price is set too high, this risks an eruption of public outrage once taxpayers realize how much of their own money they have had to cough up to pay the gambling debts of speculators who may be located in Tokyo, Canberra, or the Cayman Islands.

The chief fallacy of the "bad bank" proposal, is that by these means, the nominal value of this toxic waste can somehow ultimately be maintained, and that after a while, after the economy has recovered, they can be put back on the market. But if the ideology of credit derivatives is allowed to continue, that will never happen anyway; instead, the collapse will plunge the world even deeper into a sea of hyperinflation and bankruptcy, into a new dark age. And under those circumstances, Pakistan and Mexico would not be the only failed states, by a long shot.



The "Derivatives Family Tree," in the Financial Times Deutschland*, accompanies an article tracing derivatives to Babylonian King Hammurabi, 4,000 years ago. The caption for the illustration is: "Family Tree: Which derivatives will survive the adjustment process." Colors show which "branches" are dead, which are growing, etc.*

What to do with all this junk? Just wipe it out!

But the fact that this toxic waste is merely virtual money, means that it can be easily dealt with virtually: You don't need a bad bank; all you need to do, is strike it entirely from the balance sheets. The *Financial Times Deutschland* recently printed a useful "derivatives tree" showing the 120 most important kinds of financial paper, ranging from "twin win" certificates, to "open end turbo" certificates, to "double up/sprint protect" certificates, "bottom up options," and, for those with a sweet tooth, "plain vanilla options," to name just a few.

As I said, when you set out to solve the greatest crisis in the history of financial markets, the issue is not money, but rather whether a sufficient number of governments will recall in time their oath of office, and put their sense of duty toward the general welfare above the private interests of speculators who have gambled their money away. And in the event that the new President Obama were to signal that he will pursue policies in the tradition of Roosevelt and the principles of the Peace of Westphalia, then the first order of business for Europe's governments will be to support him in that. In his Jan. 16 webcast, Lyndon LaRouche laid out all the steps which the new Administration must take in that direction. Let us hope that it will listen to the wise words of LaRouche.