

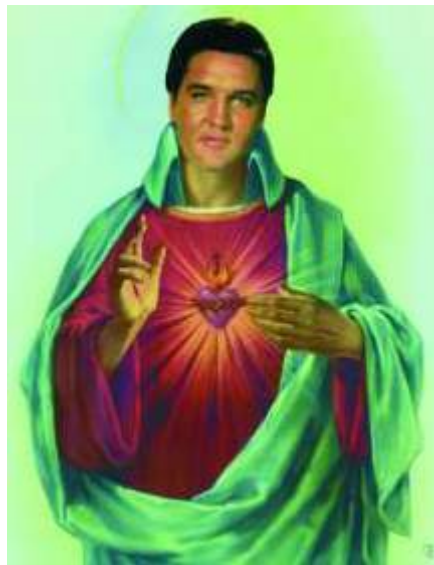
Does the bailout pass the smell test?

by Paul Craig Roberts via rialator - ICH Wednesday, Oct 15 2008, 7:47am

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The explanation that has been given for the financial crisis does not match up with the solution that has been devised. Moreover, the windows into the crisis offered by the authorities are opaque rather than transparent.



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The only clarity we have is that the crisis is resulting in financial concentration and that the bailout constitutes a massive raid by financial crooks on both taxpayers and central bank reserves in the US and Europe.

The public monies that are being directed to private financial institutions are huge. According to news reports, Germany is devoting \$540 billion to shoring up German banks, England is devoting \$73 billion, and France has pledged over \$400 billion. The US now has four separate bailouts underway, \$800 billion for banks, \$200 billion for Fannie Mae and Freddie Mac, \$85 billion for the insurer AIG, and \$25 billion for the US auto industry. These figures add to more than \$2.1 trillion.

Some of these public monies are for purchasing troubled paper assets. Others are to be directly injected into the banks as public supplied capital for private financial institutions, an ironic outcome for the free market ideology that resulted in the deregulation of the US financial system. According to news reports, in England the entire \$73 billion is being poured into banks as publicly supplied new capital. In Germany \$135 billion is for recapitalizing troubled banks. In the US Treasury Secretary Paulson is talking about using bailout money to purchase non-voting bank shares.

How is it possible that a financial crisis of such magnitude hit with such suddenness and urgency, catching finance ministries and central banks unaware?

If the problem is what the public has been told, namely that defaulting subprime mortgages are reducing the income flows through to the holders of the mortgage backed securities, why isn't the

bailout money being used to refinance the defaulting mortgages and to pay off the foreclosed mortgages? That would restore the value of the mortgage backed securities, and it would not be necessary to pour huge amounts of taxpayers' money into recapitalizing banks and purchasing their bad assets.

There is not an unmanageable number of defaulting mortgages. According to the US Treasury estimate, 90-93% of the mortgages are good. How does a 7% or 10% default rate on US mortgages translate into a systemic worldwide financial crisis?

The popping of the US real estate bubble could not produce worldwide systemic financial crisis without the mark-to-market rule, short-sellers, and a great deal of hype and orchestration. Why did Secretary Paulson let Lehman Bros. fail when every other firm is bailed out? Did Lehman's failure, by unwinding its own large portfolio, push hedge funds and banks into panic selloffs that spread the crisis at home and abroad?

The US Congress held no hearings on the crisis and consulted no independent experts. Congress responded dumbly to the financial crisis, just as it did following 9/11 when the Bush regime handed it the PATRIOT Act and the Afghan invasion. To secure Congress' acquiescence to the Paulson bailout, the Bush regime used threats of meltdown and martial law to panic Congress into turning over vast amounts of money for which accountability is lacking. The hype behind the Paulson bailout is the financial version of the mushroom cloud evocation used by the Bush regime to panic Congress into accepting the US invasion of Iraq. Is yet another hidden agenda at work?

It is unclear how the bailout will play out. The monies for the US bailout will have to be borrowed abroad or printed. If foreign central banks need their dollar reserves in order to bail out their own banks that are polluted with toxic US financial instruments, the US Treasury might not have an easy time in the debt market. Moreover, the interest expense on an additional borrowed \$700 billion will raise the US current account deficit and burden US taxpayers with higher interest payments. If the money has to be printed, inflation and dollar devaluation will depress living standards for most Americans.

If the US economy sinks deeper into recession, lost jobs and rising interest rates on troubled mortgages will result in more defaults and foreclosures, thus further impairing mortgage backed securities and requiring Congress to put more burdens on hard-pressed US taxpayers in behalf of the banks.

The authorities have blamed subprime mortgages for the crisis. Why then does their solution fail to address the problem of the mortgages? Instead, the solution directs public money into an increasingly concentrated private financial sector, the management of which is not only vastly overpaid, but also has escaped accountability for the financial chicanery that, allegedly, threatens systemic financial meltdown unless bailed out by the taxpayers.

Perhaps my nose is too sensitive, but this bailout doesn't pass the smell test.

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