Will the $700 Billion Bailout End the Crisis?

[This is a letter I sent to friends on Sept. 20, 2008, together with an AP news report (appended below). –S.H.]

Hi everybody,

Well it seems that the sheer panic has already turned into euphoria in many quarters! The Wall Street gamblers who, in their great despair, were about to utterly destroy the world economy have forced their government—the Democratic Congress as well as the Republican White House—to bail them out with another 700 billion dollars. This is on top of other recent bailouts and government commitments that total around $500 billion. So that brings it to $1.2 trillion so far. (This won't be the end of it.)

But it is a continuing panic that is leading the government officials, bankers and politicians to frantically work through this weekend and the coming week to finish the bailout plan.

And note well that almost *all* this bailout money is going not to ordinary working people, or those who are losing their homes because they can't make their mortgage payments, but to big financial corporations—the outfits who promoted this gambling around what are now recognized as "toxic assets" in the first place.

Will this end the current *financial* crisis brought about by "toxic" investments based on mortgages going sour? It will no doubt go a long way toward doing so, though there will surely be some further somewhat smaller shocks—and expenses—down the road a ways. [And maybe some even bigger ones!]

But will it also end the current overall *economic* crisis? No way! It doesn't even really address that bigger problem.

The U.S. and world economies are still sinking into recession and layoffs are still mounting. And that is going to continue. But beyond that, the most fundamental economic problems which are leading to this developing recession, and which also led to the wild housing bubble mania in the first place, are still intensifying.

Even *after* this new huge bailout of corporate criminals, there will still need to be some new bubble or bubbles created in order to get the economy moving in a positive direction again. But what new bubble seems appealing right now? A new housing bubble? That's obviously not in the cards for some time yet. A new stock market bubble? Probably to some extent, but there are still big limits to the possibilities there. (Are folks aware that even at the lowest points the stock market has reached during the past decade it has *still* been hugely overvalued by historical standards?) How about a new Dot.com or "Web2" bubble? I don't see it! Well then, how about a huge new expansion of consumer credit card debt? Are you kidding? People are struggling to make their payments already.

That leaves further massive Keynesian deficit spending, and this seems the craziest of all. Just 6 weeks ago (an eternity!) the government settled on a federal budget for the next fiscal year (beginning Oct. 1) with a record-high $482 billion official deficit. (There was some creative accounting there even then; the real number, according to former Bush Administration Treasury Secretary Paul O'Neill, "is upward of $500 billion and counting".) But in the few weeks since then, that is all moot. The new $1.2 trillion or so bailouts come close to *tripling* that deficit. The problem, though, is that most of this deficit money will go toward putting corporations accounts back where they supposedly were all along, and will not lead to much new industrial expansion. In short, this unparalleled new Keynesian deficit financing is mostly being wasted! (And I haven't even mentioned the new bailouts that will probably have to come soon to bail out the sinking U.S. automobile industry.)

So I think you see the problem. The real economy is not going to be picking up much even with this colossal deficit. If after a year or so the economy does somehow manage to shake off the recession, it will still be unhealthy, and will still need further expansion of debt *somewhere* (consumer or government) to really get it going again, and that debt must also get into the hands of those who will *actually use it* to buy new goods and services. And I just don't see where and how that is going to happen.

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One of the things that fiscal conservatives (and also some Democrats) are saying about the recent bailouts is that the public will eventually have to pay for this through higher taxes. Actually, no. The government can't possibly raise taxes enough to ever pay for either this bailout or for all the other deficits that have been piling up for decades. If the government even *tried* to do this, the economy would immediately sink into recession or worse very rapidly.

(It is true that if elected Obama will probably raise personal income taxes for the rich slightly. I certainly don't oppose this! But even if this happens it will only be a drop in the bucket, and will not even cover the inevitable new deficits in coming years let alone start to pay down the past government debt.)

The fact is that nobody is *ever* going to pay off all the government debt that is being ever more rapidly accumulated! Taxes for sure will never be able to do it. But this massively growing government debt still matters a whole lot! In the end, one (or both) of two things will cause this vast debt to be eliminated: 1) cancellation of it in the midst of general economic collapse, or 2) effective cancellation of it through hyperinflation that makes the repayment of the debt simply a matter of printing more trillion dollar bills. But either of these possibilities is probably still some great distance in the future.

For now the debt will just keep piling up, and at a generally faster and faster rate. But when it finally dawns on large numbers of people that the government will *never* be able to actually repay all its debt, then the shit will really hit the fan. This will probably happen first when foreign governments (like Japan and China) stop investing in U.S. government securities, and start dumping dollars. And these first indicators could start showing up in a serious way within the next few years.

Scott

Bush team, Congress negotiate $700B bailout

By JULIE HIRSCHFELD DAVIS and DEB RIECHMANN 09.20.08, 3:59 PM ET

WASHINGTON - The Bush administration asked Congress on Saturday for the power to buy $700 billion in toxic assets clogging the financial system and threatening the economy as negotiations began on the largest bailout since the Great Depression.

The rescue plan would give Washington broad authority to purchase bad mortgage-related assets from U.S. financial institutions for the next two years. It does not specify which institutions qualify or what, if anything, the government would get in return for the unprecedented infusion.

Congressional aides and administration officials tried to fill in the details of the proposal. The White House hoped for a deal with Congress by the time markets opened Monday; top lawmakers say they would push to enact the plan as early as the coming week.

"We're going to work with Congress to get a bill done quickly," President Bush said at the White House. Without discussing specifics, he said, "This is a big package because it was a big problem."

But lawmakers digesting the eye-popping cost and searching for specifics voiced concerns that the proposal offers no help for struggling homeowners or safeguards for taxpayers' money. Democrats say it must include mortgage help so borrowers facing foreclosure can stay in their homes.

Sen. Chuck Schumer, D-N.Y., called the plan "a good foundation," but said it was missing "some kind of supervisory authority, and some kind of protection for homeowners and taxpayers."

Still, he said such measures shouldn't slow the package down. "If we wait too long, the floor could come out and everything could crash down," Schumer said.

The proposal would raise the statutory limit on the national debt from $10.6 trillion to $11.3 trillion to make room for the massive rescue.

"The American people are furious that we're in this situation, and so am I," the House's top Republican, Ohio Rep. John A. Boehner, said in a statement. "We need to do everything possible to protect the taxpayers from the consequences of a broken Washington."

Signaling what could erupt into a brutal fight with Democrats over add-on spending, Boehner said "efforts to exploit this crisis for political leverage or partisan quid pro quo will only delay the economic stability that families, seniors, and small businesses deserve."

Bush said he worried the financial troubles "could ripple throughout" the economy and affect average citizens. "The risk of doing nothing far outweighs the risk of the package. ... Over time, we're going to get a lot of the money back."

He added, "People are beginning to doubt our system, people were losing confidence and I understand it's important to have confidence in our financial system."

Democratic Sen. Max Baucus of Montana, the Senate Finance Committee chairman, said he would push to add measures "that keep the burden of this bailout off taxpayers, mostly by making reasonable requirements of the companies asking for this emergency help."

Neither presidential candidate took a position on the proposal. GOP nominee John McCain said he was awaiting specifics and any changes by Congress. "This financial crisis requires leadership and action in order to restore a sound foundation to financial markets, get our economy on its feet, and eliminate this burden on hardworking middle-class Americans," McCain said in a statement.

Democratic rival Barack Obama used the party's weekly radio address to call for help for Main Street as well as Wall Street.

"We need to help people cope with rising gas and food prices, spark job creation by repairing our schools and our roads, help states avoid painful budget cuts and tax increases, and help homeowners stay in their homes," Obama said. "And we must also ensure that the solution we design doesn't reward particular companies, or irresponsible borrowers or lenders, or CEOs, some of whom helped cause this mess."

Their language reflected a tricky balance that politicians in both parties are trying to strike, just six weeks before Election Day: Back a plan that doles out hundreds of billions to companies that made bad bets and still identify with the plight of middle-class voters.

Besides mortgage help, Democrats are considering attaching additional middle-class assistance to the legislation despite a request from Bush to avoid adding controversial items that could delay action. An expansion of jobless benefits was one possibility.

Bush sidestepped questions about the chances of adding such items, saying that now was not the time for posturing. "I think most leaders would understand we need to get this done quickly, and you know, the cleaner the better," he said about legislation being drafted.

The draft does not specify which financial institutions would be eligible for the help, leaving open the question of whether hedge funds or pension funds could qualify. Congressional aides said that omission appeared to be by design, as the question of who could get help under the bailout is still up for negotiation.

The proposal does not require that the government receive anything from banks in return for unloading their bad assets. But it would allow the Treasury Department to designate financial institutions as "agents of the government," and mandate that they perform any "reasonable duties" that might entail.

The government could contract with private companies to manage the assets once it purchased them.

Treasury Secretary Henry Paulson says the government would in essence set up reverse auctions, putting up money for a class of distressed assets - such as loans that are delinquent but not in default - and financial institutions would compete for how little they would accept.

If enacted, the plan would give the treasury secretary broad power to buy, manage and sell the mortgage-related investments without any additional involvement by lawmakers. It would, however, require that the congressional committees with oversight on budget, tax and financial services issues be briefed within three months of the government's first use of the rescue power, and every six months after that.