MONEY MORNING

105 West Monument Street Baltimore, MD 21201

Why the $700 Billion Bailout Bill Will Fail U.S. Taxpayers

There are eight major reasons we should fear the passage of this colossal bailout bill. There's also eight ways the U.S. government could have solved the problem without putting a burden on taxpayers.

By Shah Gilani, Contributing Editor, *Money Morning*

My sister lives in a landmark building in Coral Gables, Fla. There was a fire in one apartment in the building. After that fire was brought under control, the fire department – for some unknown reason – dropped a hose in the burned apartment, and left the water running … for hours.

That inane maneuver destroyed many apartments, crippled the building's infrastructure and resulted in the building being temporarily condemned. The entire building was closed down for many months. Every person who lived there had to relocate. My sister, fortunately, had the wherewithal to take up temporary residence in the world-famous Biltmore Hotel.

But others weren't so lucky.

When the banking-system bailout plan – formally referred to as the "Emergency Economic Stabilization Act of 2008" – was originally unveiled, the financial-crisis firefighters at the U.S. Treasury Department were essentially reprising the Florida firefighting strategy. And U.S. taxpayers can anticipate an outcome a lot like the one that afflicted the Coral Gables apartment dwellers.

Unfortunately for the U.S. taxpayer, there's no Biltmore in which to seek temporary shelter. There's only one U.S. economy, and we have to stay in it, **whether it's been condemned or not**.

Treasury's Eight-Point Plan – for Failure

In plain English, here's what's wrong with the newly passed "bailout" plan and what alternatives should have been included as part of any plan that had a hope for success.

The Treasury plan was originally predicated on buying $700 billion of collateralized residential mortgage-backed securities that banks could not unload. The idea was that the banks would get the

money, which they could then turn around and lend to keep the credit markets open and credit flowing throughout the economy. In the meantime, the Treasury Department would sit on the securities until it is able to sell them, hopefully at a profit. The idea, from a *theoretical* standpoint, isn't stupid. **It is, however, impossible to implement to any degree that will result in its intended effect.**

Here's why:

1. **There are more than $1 trillion worth of subprime collateralized mortgage-backed securities out there – and that's just one type of problematic derivative security.** The bottom line: $700 billion isn't enough. Period.
2. **The purchase plan is not limited to just residential mortgage-backed securities.** Surprise! What else will Treasury buy?
3. **Who's going to fight off the lobbying groups out to influence the managers that the Treasury Department hires to direct money to their masters?** Did we mention that $700 billion wasn't enough?
4. **The government plan is even more under-funded than people realize, for it doesn't authorize the full $700 billion:** Indeed, it starts with only $350 billion, leaving an even greater shortfall. Did we mention that $700 billion wasn't enough?
5. **Treasury is going to hire banking-industry managers to manage the process.** Those managers are going to serve themselves – just as they served themselves to get us into the crisis.
6. **There is no defined mechanism to determine what price the Treasury Department will pay for what it buys.** For argument's sake, even if Treasury were to only buy the problem securities its leadership speaks of in public – residential mortgage-backed securities – there are problems if it prices them too low: If that happens, some holders won't sell them, taking the chance that if they hold them long enough they will be worth more than Treasury is willing to pay. How will those financial institutions regain liquidity if they won't sell the securities needed to make this happen?
7. **Since Treasury can't buy all the problem securities, if it prices what it's going to buy too low, all remaining holders will have to mark down their holdings and take more write-downs and losses.** How will that create confidence and facilitate "liquidity"?
8. **However, if the Treasury Department prices the securities too high, several problems quickly emerge:** Hedge funds will rush to sell their current holdings, and may very well speculate by buying up more securities to sell them at a higher price (profit) to Treasury, meaning that the Treasury Department plan won't necessarily be helping banks directly. What's more, if those securities are priced too high, and the market for them continues to fall, taxpayers will eat the losses – a reality that likely will lead to an end to further program funding.

The "Heads I Win, Tails You Lose" Bargain

How are the Treasury Department and the U.S. Federal Reserve going to be able to conduct

objective, responsible policy regarding fiscal matters and interest rate decisions when they will have to simultaneously "manage" the government's portfolio of securities? There will be conflicts and there will be fallout for the U.S. dollar and fallout with regard to American interests vs. the rest of the world, with whom we trade and partner with in all manner of ways, not the least of which involves our own national security.

While the idea that taxpayers should get warrants and ownership in the entities that we buy securities from is *theoretically* a good idea, there are some issues. Let's take a look at some of the biggest potential pitfalls:

- **Foreign banks aren't going to be thrilled about that;** yes, they are included in the list of whom the Treasury will buy from.
- **Are taxpayers going to be limited partners in hedge funds?** What if those hedge funds implode?
- **The U.S. Treasury Department could end up in control of our banks.** Considering how well they run the government's fiscal house, is that what we want?
- **Who is going to decide when to sell any of government's ownership interests, should they turn out to be profitable?** Will we own these businesses forever?
- **Is government going to control private enterprise?** Is this a ruse? Are we heading into an era under the stewardship of a socialist government?
- **There is no direct support for homeowners in the plan and no support mechanism for falling home prices.** And yet, these twin evils are the root causes of what has happened.

After the House rejected the initial bill – and U.S. stock prices plummeted – the Senate rushed through its modified plan, which the House subsequently passed and the president signed. But that was just another hose from the same firefighting gang that can't shoot straight; which will further douse the prospect of a directed approach.

Here are some of the additions that were made to the plan that the House originally rejected – meaning they are part of the plan that was signed into law. Ask yourself this question: What do they do to actually address the credit crisis?

- **Extend unemployment benefits:** That's super – so when *we're* all out of our houses, we'll have enough unemployment to stay at the Biltmore for a day or two.
- **A $1,000 tax deduction for homeowners who don't itemize.** Great, I can buy a cheap inflatable raft to float away on the red ink that flows out of my house.
- **A reduction on the tax on dividends repatriated from foreign earnings.** *What?*
- **Economic stimulus measures – such as spending on transportation projects.** That will actually help; if they build canals around my house, when I float away on my red-ink raft, at least I won't end up in uncharted waters.
- **Increase Federal Deposit Insurance Corp. (FDIC) deposit-insurance-coverage per bank account from $100,000 to $250,000.** That will definitely calm nervous bank depositors, espe-

cially all those who have more than $100,000 in their many accounts. Personally, I wish I had that worry. Do you?

What is the common denominator to all these add-ons? They are meant to be added up so that Congress can say: “This is how much we’re going spend to help fix the problem that will benefit you, not just the $700 billion going to Wall Street.” Don’t buy into this.

However, my very favorite proposal is the push to do entirely away with fair-value – mark-to-market – accounting. This is being pushed by none other than the American Bankers Association and – guess whom else – the Securities and Exchange Commission (SEC). That’s the same SEC that presided over the demise of The Bear Stearns Cos. (now part of JP Morgan Chase & Co., Lehman Brothers Holdings Inc., and American International Group. It’s the same SEC that eliminated the up-tick rule. And it’s the same SEC that handed over to the exchanges the authority to decide who should be on the “do-not-short” list.

The truth that needs to be front-page news it that if there wasn’t Fair Value, mark-to-market accounting we would never have seen this crisis coming. Doing away with mark-to-market accounting does not change the value of problem securities. Period. Doing away with mark-to-market will only bury the bodies under the rubble. The stench will eventually suffocate us all…to death.

A Real Solution

On top of the list of solutions should be an immediate address of:

1. Regulation.
2. The nature and existence of problem securities.
3. A means of accurately and transparently pricing those problem securities.
4. A cleanup of attendant problem instruments (credit default swaps) that are massively contributing to the problem and – in and of themselves – are sinking the U.S. economy.
5. The need to facilitate an accounting aide – short of eliminating mark-to-market accounting – by directly addressing how banks can still hold these problem securities and not have to incur unrealistic write-downs and losses.
6. A means of allowing problem securities to be used as collateral when borrowing from the Fed.
7. A method of helping homeowners directly.
8. A strategy that will support the housing market with sensible tax and capital gains policies.

The problem right now is that we’re being force-fed a political solution in the immediate glare of an election, instead of a sound economic, market-based solution to a financial crisis.

The 228 House Representatives who put aside political pressure to heroically vote against a flawed plan should have taken the lead in this firefight to offer up an alternative plan. It just so happens there was a really good one out there. The problem is that it wouldn’t serve the “Masters of the Universe,”

the lobbyists, or the politicians who are paid off by both.

[Editor's Note: R. Shah Gilani – a retired hedge fund manager and a nationally known expert on the U.S. credit crisis – has predicted five key financial crisis "aftershocks" that he says will create substantial profit opportunities for investors who know just what these aftershocks are, and how to play them. In the Trigger Event Strategist, trigger events," as gateways to massive profits. To find out all about these five financial-crisis aftershocks, and about the trigger-event profit strategy they feed into, check out our latest report.]

THE MONEY MAP PRESS

Copyright 2009–present, Money Map Press, *LLC 105 W. Monument St., Baltimore, MD 21201*

All rights reserved. No part of this report may be reproduced or placed on any electronic medium without written permission from the publisher. Information contained herein is obtained from sources believed to be reliable, but its accuracy cannot be guaranteed.

Money Map Press Disclaimer: *Nothing published by* Money Map Press *should be considered personalized investment advice. Although our employees may answer your general customer service questions, they are not licensed under securities laws to address your particular investment situation. No communication by our employees to you should be deemed as personalized investment advice. We expressly forbid our writers from having a financial interest in any security recommended to our readers. All of our employees and agents must wait 24 hours after on-line publication or 72 hours after the mailing of printed-only publication prior to following an initial recommendation. Any investments recommended by* Money Map Press *should be made only after consulting with your investment advisor and only after reviewing the prospectus or financial statements of the company.*

MMBAI0109