Spain Forced To Seek Bailout; Glass-Steagall Push Intensifies

by Nancy Spannaus

June 11—After weeks of being beaten about the ears by the Obama Administration, the IMF, the gathered Eurozone finance ministers, and the London-run international banking community, the Spanish government of Mariano Rajoy on June 9 finally agreed to "request" a bailout package from the European Financial Stability Facility/EFSF (or the soon-to-be-created European Stability Mechanism/ESM), to the tune of some EU100 billion. The money will be lent to Spain's Fund for Orderly Bank Restructuring bailout facility, which in turn will use it to try to stop the massive run on Spain's bankrupt banks.

Desperately trying to avoid the kind of bloody conditionalities which the IMF-EU-ECB Troika has imposed on Greece, Spanish Economy Minister Luis de Guindos told the press, after the Eurogroup meeting of Eurozone finance ministers: "This has nothing to do at all with an absolute bailout. It is financial support aimed and given to the Spanish bailout fund and the Spanish bailout fund will inject this capital to those Spanish institutions that require it as stated by the IMF."

The British-based financier cabal was desperate to get Spain to cave in this weekend. But in fact, the announcement—which is still all in the realm of stated intentions—will do absolutely nothing to resolve the fundamental bankruptcy crisis staring the entire trans-Atlantic financial system in the face. Solving that crisis demands, as Lyndon LaRouche's article above reiterates, taking the bad gambling debts off the books, by implementing Glass-Steagall.

Thus, it is lawful, and good news, that leading financial spokesmen are now stepping forward to campaign for Glass-Steagall. Particularly notable were op-eds published in the June 11 *Wall Street Journal* and *Financial Times*, by former Kansas City Fed chairman Thomas Hoenig and University of Chicago Prof. Luigi Zingales, respectively, both of whom unambiguously promote the return to the Glass-Steagall principle.

The Spanish Bailout

As the *New York Times* put it, the Spanish announcement came "following increasingly desperate calls from world leaders to accept the money before Greek elections next week, that they fear could cause havoc in the markets." Spain's announcement was met with plaudits from the IMF, the EU bureaucracy, and of course, U.S. Treasury Secretary Tim Geithner—no newcomer to hyperinflationary bailouts.

The EU100 billion figure is meaningless in the face of the size of the actual blowout underway. The *Financial Times* earlier this week estimated that the amount required to bail out the Spanish banks was probably closer to EU475 billion. *EIR*'s conservative estimate is in the EU600-700 billion range for the banks—and over a trillion euros for the country as a whole.

In addition, it is not at all clear that there is any fund available that could accomplish such a bailout. By applying for funds, the Spanish government has taken itself off the donors list for the EFSF, the entity first in line to provide the money, thereby reducing the amount available for bailouts to approximately the same amount that Spain is expected to apply for! The ESM does not yet exist.

Even before De Guindos had finished crying "uncle!" the markets escalated the attack on Spain. Moody's rating agency said that the agreement will probably spur further downgrades of Spain's credit rating. And Bloomberg quoted investment banker Nicholas Spiro stating: "Market reaction is unlikely to be favorable, given that the bailout places even more strain on Spain's creditworthiness."

It Didn't Take Long

Surprising even hardened financial "experts," who expected the Spain bank bailout to "work" for as much as several hours, the bailout had actually failed before being formally announced—a new speed record that should, by all reason, be allowed to stand forever. The causes of this lightning collapse should be understood, so that bank bailouts be buried forever.

Spanish government bond yields *rose* this morning, to 6.54% for a ten-year bond, 0.3% higher than the June 8 closing level which helped panic Spain's government

Former Kansas City Fed chief Thomas Hoenig is pushing for a return to Glass-Steagall.

into "requesting" the bailout. Credit default swaps (CDS) on the Spanish government debt zoomed higher in price. And the contagion spread to Italy, where Spanish debt dragged Italian debt to a ten-year yield of 6.04%, up more than a quarter of a point from June 8. One may be sure that the same thing is happening with Eurozone *bank* debt, as with sovereign debt.

The "agreed" bailout was to pile EU100 billion in new debt on top of Spain's sovereign debt, and on top of the bonded and short-term debt of Spain's bad-asset-loaded banks. The mechanism was to be a credit line from some EU bailout fund, which Spain's bank restructuring agency would use to replace the capital of banks, which would have agreed to write off *some* of their bad assets, thus impairing (reducing) their capital. It might have been predicted that the EU100 billion would shortly be used up in this manner, leading to requests for more bailout.

For bad-asset-loaded, undercapitalized, overleveraged banks, this new debt does not improve the situation, as the Greek default and "haircut" proved. The new debt is "senior," being from a supranational bailout agency, and thus immediately subordinates all the other debt of Spain, which guarantees repayment; and of the banks (which already owe EU330 billion to the very-senior ECB, which tolerates no "haircuts" on its loans). So, these loans must be repaid even if other Spanish government and bank debt is defaulted to do so, and all "markets" know this; there is no prospect of economic expansion which would enable Spain or its banks to magically service more debt than the debt they couldn't keep servicing before the bailout.

So the results of this bailout, like Greece's, were pre-fixed: Spain will be further downgraded, Spanish banks will be further downgraded, and by contagion, Italian, French, etc., sovereigns and banks will be downgraded, etc.—while Obama/Geithner, the U.K.'s Cameron/Hague, the IMF's Madame Lagarde, and the EU bureaucrats demand a further, even more gigantic bailout, likewise built to fail.

It might also occur that the Spanish bailout, announced to have no austerity "conditions," because "Spain is in a recessionary situation," will thus strengthen the anti-austerity forces in the June 17 election in Greece, which is in a depressionary situation.

The Demand for Glass-Steagall

While this deadly financial chicken-game continues, the good news is that the drumbeat for Glass-Steagall is growing.

"Why I was won over by Glass-Steagall" is the title of a call published in the *Financial Times* June 11 by Italian Prof. Luigi Zingales, at the University of Chicago Booth School of Business. Zingales admits to having opposed Glass-Steagall before, but he now understands that its elimination led to giving the major financial powers "excessive power." He also argues for the simplicity of Glass-Steagall over the 298-page (yet to be completed) "Volcker Rule," arguing that the more complicated a rule, the "more difficult it is for someone with vested interests to get away with distorting some obscure fact."

Simultaneously, former Fed official Thomas Hoenig, a well-known Glass-Steagall supporter who has remained relatively silent over recent months, also went public again for its reinstatement, this time in the *Wall Street Journal*, which specializes in attacking regulation. Hoenig refutes the two biggest arguments against Glass-Steagall: that it would not have prevented the collapse; and that it is against free-market ideals and would put the U.S. at a disadvantage in the current economy.

Hoenig, now a director of the Federal Deposit Insurance Corporation, can exert a significant influence on national policymakers, especially Republicans, who are still largely in the background of the political fight for Glass-Steagall in Congress, and around the nation, led by LaRouchePAC and its supporters.