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## Taxes to Bail Out Robert Rubin

By Dean Baker  
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Monday 25 February 2008

No one wants to pay higher taxes, but when the big banks are in trouble, who could be so heartless not to open their pocketbooks? That seems to be the consensus in the media in their discussion of the latest set of plans to bail out the Wall Street clowns who are losing hundreds of billions of dollars in the housing market meltdown.

Just to remind everyone, we are in the middle of a meltdown of an \$8 trillion housing bubble. In the most recent data, house prices were declining at a 16 percent annual rate. This rate of price decline implies a loss of \$3.2 trillion (more than \$40,000 per homeowner) over the course of a year. This collapse is throwing the economy into a recession and leading millions of people to lose their homes.

As part of this story, most of the major banks have taken huge hits as a result of the fact that the financial wizards who guide them apparently didn't know what they were doing. Most of these banks have seen their stock prices tumble by 50 percent, or more, as they have taken write-downs of bad debt that now exceed \$100 billion. Citigroup, the gargantuan bank that has former Treasury Secretary Robert Rubin near the helm, currently tops the charts with more than \$20 billion in write-downs. Everyone agrees there is much more on the way.

Clearly these are desperate times, but fortunately the government is there to lend a helping hand. The Office of Thrift Supervision (OTS), the agency that supervises the country's savings and loan institutions (that's right, as in the huge bailout of the 80s), has come up with a

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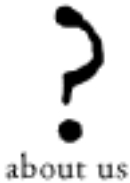
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brilliant plan to help the banks. They want to hand them tens of billions of dollars by having the government buy up bad mortgage debt.



Here's the deal: The foreclosure rate is at a record high and rising rapidly. The collapse of the housing bubble has left millions of homeowners with mortgages that are underwater, with the value of the mortgage exceeding the value of their house. This makes it more difficult for them to hang onto their homes if they want to, since homeowners have no equity against which they can borrow to pay their mortgages in bad times. This situation is aggravated by predatory mortgages that were peddled en masse in the bubble years.

Other homeowners may no longer want to keep their homes because they owe more than the value of their house. It doesn't necessarily make sense to pay off a \$240,000 mortgage on a house that is worth \$200,000. For this reason, millions of homeowners are simply allowing banks to foreclose on their homes, letting them eat large losses on their loans.

The OTS plan has the government come to the rescue in this crisis. It would have existing loans restructured so underwater mortgages would be broken into two parts. A new mortgage would be issued that is equal to the current market value of the house. This new mortgage is guaranteed by the government.

The other portion of the mortgage is turned into a certificate that is equal to the difference between the value of the original mortgage and the current value of the house. This certificate is a claim against the sale value of the house, if it exceeds the value of the new mortgage.

In the example used by the OTS, the original mortgage is \$220,000 for a home that is now worth \$200,000. In this case, the new guaranteed mortgage is equal to \$200,000. The holder of the old mortgage gets a certificate for \$20,000. This certificate gives the holder (it can be traded) a claim against any money the homeowner gets from selling the house, after paying off the mortgage, up to \$20,000.

The OTS would have us believe this is a win-win for homeowners, investors and the public. While they may have convinced the born-yesterday crowd that reports the news, it's not hard to find the trick.

House prices are falling. The home appraised (do we have honest appraisers?) for \$200,000 today is likely to be worth 15 percent to 30 percent less in a year or two. That means a very high portion of the mortgages guaranteed today will subsequently go bad, requiring the

government to make good on the guarantee.

To use the OTS numbers, suppose we put up \$100 billion to guarantee 500,000 mortgages (\$200,000 per mortgage). Let's say 40 percent of the mortgages subsequently go bad, costing an average of 50 percent of the face value, since homes will have to be sold at large losses. That means the OTS scheme will cost taxpayers \$20 billion.

Of course proponents of the OTS scheme will point out we still allowed 300,000 low- and moderate-income families to stay in their houses. That is not much to show for our \$20 billion investment. First, a substantial number of these homeowners - say 100,000, or one fifth - would have kept their homes in any case. That means we spent \$20 billion to keep 200,000 people as homeowners. That's \$100,000 per homeowner.

Furthermore, the vast majority of these homeowners will sell their homes before they ever accumulate a dime in equity. And they will almost certainly pay far more in mortgage and property tax each month than they would pay to rent a comparable home. This is housing policy that only a hare-brained Washington bureaucrat could love.

Oh yeah, the policy is an effective way to get money to Citigroup and other troubled banks, so at least it will do some good.

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*Dean Baker is the co-director of the [Center for Economic and Policy Research \(CEPR\)](#). He is the author of [The Conservative Nanny State: How the Wealthy Use the Government to Stay Rich and Get Richer \(www.conservativenannystate.org\)](#). He also has a blog, "Beat the Press," where he discusses the media's coverage of economic issues. You can find it at the [American Prospect's web site](#).*

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