trend continues, the less the range of choices the incoming president will have in the conduct of foreign affairs.

As for ameliorating the international trade agreements many Americans believe have been detrimental, forget about it. In straight power terms, America, now the world's largest debtor nation, cannot raise tariffs to bar creditor nations' merchandise. A person does not order around those to whom he owes money and from whom he is borrowing more.

Far from obtaining concessions from America's creditors and bond holders, the new president will have to worry about what was once an impossibility—that foreign creditors and investors, scared by the diminishing dollar and the inability or refusal of the American government to take remedial steps, will head for the exits or, worse, panic and stampede to get out of dollars and into euros, pounds, yen, and yuans.

On a smaller scale, this is exactly what happened to Bear Stearns. Should such a series of events unfold nationally, Americans will suffer huge inflation, evaporation of savings, bankruptcy, unemployment, and the kind of social strain from which much ugliness and even regime change have been known to flow in other nations that have tripped into this kind of abyss.

None of that need be. There is a way out, but it is not a happy-go-lucky one. The next president will have to tell the nation to man up. The remedy the new White House occupant cannot help but announce is the castor oil of austerity, an indefinite postponement of much that millions want. That's what you do when there is no money and you are in debt. Americans have faced worse in their history. They can do it again. ■

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[brother, can you spare a billion?]

Papering Over the Problem

Killing the dollar to save Bear Stearns

By Wilson Burman

AS THE NEWS BROKE on March 14 that the Federal Reserve would backstop the rescue of Bear Stearns by JPMorgan Chase, it's unlikely that many of the drivers paying record-high prices at the gas stations off the West Side Highway thought to glance toward midtown, where two sleek towers housed the beneficiaries of the Fed's largesse. But those unhappy drivers, along with every other taxpayer and consumer in the U.S., had just become partners in a deal that offers considerably greater risk than reward.

Headlines notwithstanding, this was not a "bailout" in the most widely understood sense of the word. Bear Stearns lasted barely a full trading day between the Fed's action and the announcement of the acquisition by JPMorgan at $2 (later raised to $10) a share. Essentially it was a government intervention. To keep Bear Stearns temporarily afloat, the Federal Reserve extended credit through JPMorgan and agreed to bear the risk of loss on Bear's collateral to the tune of $29 billion. The move stirred memories of Long Term Capital, the 1998 hedge-fund bailout that the Fed organized but did not fund, or the Resolution Trust Corporation, the government's massive publicly financed response to the Savings and Loan crisis. On the continuum of expediency, the Bear Stearns episode falls somewhere between the two.

There were some understandable reasons for the Fed to go through JPMorgan instead of lending to Bear directly. As a practical matter, Morgan is a commercial bank, so it has access to the Fed's discount window. Also, because of the established relationship between the two firms, Morgan could quickly evaluate Bear's collateral for the loan. But there was another reason. The Fed realized that a direct, overt bailout of a hugely profitable Wall Street firm wasn't feasible politically, particularly in an election year and during a recession. A latter-day RTC wouldn't fly right now. But that doesn't mean the situation lacks serious consequences. By dipping into the public till to help a medium-sized Wall Street firm that's not part of the commercial banking system, the Fed implicitly pledged at least partial assistance to a whole raft of firms higher up the food chain. Of course, the unstated but understood guarantee of the government-sponsored enterprises like Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks has always existed. But now, because the government deemed Bear Stearns worthy of a backstop worth tens of billions, taxpayers stand behind firms like Goldman Sachs, Merrill Lynch, Lehman Brothers, and Morgan Stanley as well.

That is the deal the Federal Reserve has made on behalf of the public. It's the latest chapter in the socialization of risk and its corollary, moral hazard. Anyone who works long enough on Wall Street knows, at least subconsciously, that this is the way things work: if the going gets tough, a small coterie of unelected and mostly unaccountable officials in Washington will probably decide that your employer is too important to fail. In an effort to keep that from happening, wages, savings, fixed-income streams, and Social Security checks will be inflated away to "ensure the stability of the financial system." Creative destruction is the mantra until things threaten to get creative in the Hamptons.

Just because the Fed understood the implicit obstacles to funding a classic, sustaining bailout of Bear Stearns doesn't mean the temptation wasn't there. The media almost always misses an important reality: monetary policy can effect a *de facto* bailout, particularly for Wall Street, almost as easily as a direct handout. In the weeks leading up to the Bear Stearns debacle, the Fed wasn't bashful at the levers of policy. One such lever is temporary open-market operations, which the Fed uses on a daily basis to target short-term interest rates. When the Fed adds reserves to the banking system, the salutary effects of the associated liquidity spill over into other instruments, including stocks and commodities. In early February, the value of this temporary liquidity pool was $15 billion. As stress increased in the financial markets, the Fed boosted that to a high of $77 billion on March 12— just as trading-desk rumors about a possible bank failure peaked and two days before the intervention to support Bear Stearns.

The Fed was busy in other ways. That same week, on March 11, it announced formation of the Term Securities Lending Facility, to accept lower-quality collateral from primary dealers, of which Bear Stearns was one. This was just one new program whereby the Fed takes

DEEP BACKGROUND

Israel is the only country in the world that has a policy of "directed assassinations" of its enemies and U.S. Director of National Intelligence Mike McConnell is apparently prepared to go along with Tel Aviv's efforts to conceal that activity. Israel has denied that it was behind the assassination of Hezbollah Deputy Secretary General Imad Mughniyeh in Damascus on Feb. 12, a claim supported by McConnell, who suggested the death was probably the result of internal conflicts within Hezbollah. But the CIA investigation of the bombing has revealed that the Israelis carried out the killing using Palestinian refugees they had recruited. The assassination quickly became an open secret in Tel Aviv, with Prime Minister Ehud Olmert congratulating the head of Mossad. And the Syrian government may have been complicit, allowing the operation to proceed because Mughniyeh was becoming an embarrassment. After attending a diplomatic reception at the Iranian Embassy, he had been returning to his parked car when another vehicle behind his exploded, killing him instantly. The use of remote-controlled explosives is well within the capabilities of every intelligence service in the Middle East, but the set-up for the operation raises a number of questions. Mughniyeh normally traveled with a Syrian government-provided armed bodyguard. The guard was absent that night. Also, foreign embassies in Damascus have police details outside, making it impossible to park the bomb vehicle without it first being inspected and cleared. Mughniyeh had been implicated by the CIA in the deaths of several Agency personnel in Lebanon and also Chief of Station William Buckley, but he was thought to be semi-retired and had more or less fallen off our screen—but not Israel's.

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It appears to be no coincidence that President Bush, Sen. John McCain, Gen. David Petraeus, and Vice President Dick Cheney have all again been denouncing Iran. President Bush's declaration that Iran wants "a nuclear weapon to destroy people" was later qualified by a spokesman insisting that Bush was only "speaking in shorthand," but Iran-bashing is once more officially in season. Some intelligence officers opposed to an Iranian adventure are nervous that something is afoot, reportedly because the White House has asked for some "new initiatives" against the mullahs. Sources in the White House are saying that the security card will be played heavily in the lead up to the November elections.

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An unidentified U.S. Navy nuclear submarine stationed in the Red Sea has joined the fight against international terrorism. On March 3, three Tomahawk cruise missiles were launched against a target in the Somalian town of Dobley, which straddles the border with Kenya. According to local mayor Ali Hussein, three civilians were wounded, a house damaged, and three cows and a donkey killed. The target of the attack, Saleh Ali Saleh Nabhan, a Kenyan who was allegedly involved in attacks on Israeli tourists in Mombasa, Kenya in 2002, was not present. Nabhan is not even an identified terrorist. He is only on the FBI list for questioning in connection with the Mombasa attacks. Tomahawk cruise missiles cost $1.5 million each.

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