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Sent: Saturday, October 18, 2008 6:14 PM
To: Subscribers to Professor Paul Zane Pilzer Newsletters (www.paulzanepilzer.com)
Subject: Professor Paul Zane Pilzer on the Current Economic Crisis

Dear Subscriber to the Paul Zane Pilzer Newsletters:

Since the collapse of Lehman Brothers on September 15, 2008, Professor Pilzer has received hundreds of inquiries asking about his position on the current financial crisis and the proposed government bailout. Paul and I would prefer to answer each of these inquiries individually. However, since the volume of requests makes this impractical, we are distributing the information below to all of Paul's subscribers.

Paul has spent most of the last month on the financial crisis issue, working with businesspeople, government officials, and politicians. At this time we cannot share with you the details of these efforts, as everyone working with him is committed to the betterment of our nation and has agreed to refrain from using the bailout for personal or political gain.

However, earlier this week Paul appeared on Oprah and Friends to discuss the financial crisis. Excerpts from the interview are posted on www.Oprah.com (click "Radio" in the link bar at the top of the page, then click "Jean Chatzky," "Past Shows," "10/13/08 Market Update," and "Listen In").

Highlights from this Oprah and Friends interview, and Paul's opinions on the financial crisis, are shown below. This email will not be posted on our website.

Kathy Earnshaw
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October 13, 2008 Comments of Professor Paul Zane Pilzer on the Current Economic Crisis and the $810 Billion Bailout

1. The Economic Ability to Afford the $810 Billion Bailout

I believe that our nation can easily afford the $810 billion bailout of banks and home mortgages. Our national debt is about $10 trillion (that's $10,000 billion), which is a very-affordable 68% of our $15 trillion Gross Domestic Product (GDP). This is roughly equivalent to having a $68,000 mortgage on your home when the family's take-home income is $100,000/year. Adding $810 billion to the $10 trillion national debt is akin to adding $8,100 to your $68,000 mortgage. While the additional debt is unfortunate, it will not bankrupt the nation or lead to rampant inflation.

2. Estimated Cost of the Mortgage-Backed Securities Crisis

I estimate that, by the time the dust settles, the mortgage crisis will have cost the nation approximately $150 billion. It may actually cost much less. The mortgage-backed security issue is similar to Y2K (the computer-related fears that were rampant as the year 2000 approached), which the media widely exaggerated by a factor of 10 or more. There are 160 million American households, of which approximately 102 million are owner-occupied homes. Assuming there are approximately 90 million mortgages, with 3% of them in foreclosure, and that half of this 3% will be foreclosed on at an average loss of $100,000 each, the total loss would be $135 billion.

Moreover, the current mortgage foreclosure problem is very regional and there is no "one size fits all" solution. Six of the states have more than half of the total problem, and for different reasons. The foreclosure problem in California, Florida, and Arizona is primarily caused by overbuilding, while the problem in Michigan and Ohio is primarily caused by unemployment (mostly in the automobile industry).

3. The Real Crisis Could Be Mismanaging the Banking Crisis

I am less optimistic about a potential worldwide depression that could result from mismanaging our current banking crisis. The 228 congressmen and congresswomen who voted "No" on the original bailout package in September were either ignorant of the relevant financial issues or were selfishly grandstanding for personal political gain--and for either reason should be voted out of office this fall.

As an American, and a sometimes politician, my words cannot express how proud I was last month when both Presidential candidates suspended their campaigns, flew to Washington, and worked the phones all night to get their political colleagues to vote for the banking bailout. I was delighted to see that our primary system had worked so well in fielding Presidential candidates of such character. This was another great example of how well God has blessed our nation.

Today, our “currency” is our banking system. Imagine what would happen if I were to take all of your cash from you and put a freeze on your credit cards and checking account. How would you pay your mortgage and housing expenses, procure food for your family, or even drive to work? How would employers be able to run their businesses and pay their employees? That’s what could happen if we allow major banks to fail indiscriminately. Covering the liabilities of all of the banks may not be fair, but it is necessary to keep our economy solvent at any cost.

4. Our Greatest Risk May Be Credit Default Swaps (CDS)

A bigger issue, the magnitude of which is still unknown, is Credit Default Swaps (CDS). A CDS is an unregulated (and usually unreported) guarantee of a financial instrument, typically by a financial institution. Many of these CDS's were issued by traders who didn't think of them as risk because they simultaneously hedged their risk with another (relatively riskless) institution. And, in fact, they *were* relatively riskless--until various major players (starting with Lehman Brothers and leading to AIG) became insolvent.

Consider a bookmaker taking a $1 million bet from Person A with 2-to-1 odds that Candidate A will win the election, and simultaneously taking an offsetting 2-to-1 $1 million bet from Person B that Candidate B will win the election. The bookmaker earns a 2% fee ($20,000), and when Candidate A wins the election the bookmaker collects $1 million from Person B and pays $1 million to Person A.

Now, what happens if the losing bettor goes bankrupt? The bookmaker, who thought of himself as hedged, is out $980,000, and cannot pay Person A. Moreover, Person A, who was expecting the $1 million, needed that money to pay off many other bettors. Multiply this by thousands of bettors for each bookmaker to the tune of tens of trillions (yes, trillions) of dollars and you can see the magnitude of the potential problem.

CDSs are really "insurance without regulation.” Insurance is a highly regulated industry where insurers are required to keep reserves and disclose their risks, yet the majority of CDS's were not even recorded as risk, for a multitude of reasons. As a former financial industry executive (Citibank), and a former financial regulator (Reagan

Administration), my colleagues and I are working on ways to ascertain the size of the CDS problem and ensure that our Treasury has the tools they need to put out each financial firestorm as it occurs.

5. The Future of the American Economy

Ultimately, the economy will survive this crisis and will actually be much stronger as a result of it. As a nation, we have become too complacent, and there are many ways in which we can improve—both economically and spiritually. Family-by-family and friend-by-friend, I am already seeing people reflect on what is truly important in their lives and focus on what they have left rather than on what they have already lost.

My short-term views on the economy change daily, and, during the last 45 days, I have been wrong more than I have been right. However, as of today, I am expecting a continuing short-term decline in the Dow this fall and then a long sustained recovery of the stock market for several months after the election.

6. The Future of the World Economy

I am less optimistic about the economic impact on lesser nations--the poorer people of the world will feel the wrath of an economic decline much sooner and much harder than people in the United States.

In the Wild West of the 1800s, you put your money not in the bank that paid the highest interest, but in the bank that was the most stable and had the strongest security guards. In the Great Depression of the 1930s, there was no safe haven for capital, as the United States was just another nation in the worldwide depression.

This time, the enormous military power of the United States, coupled with our political stability, makes the U.S. a safe haven for investors worldwide. This flight to safety of capital is already occurring—driving the short-term interest rate of treasuries to almost zero percent. Unfortunately, much of this money now flowing to the U.S. is the seed capital from wealthy investors in poorer nations—capital that the average person in these nations sorely needs to sustain his or her basic livelihood, and that these nations need to fuel their own economic recovery.

Conclusion

Thank you for listening. I wish I had more time, and more ability without violating confidences, to share with you everything I see right now.

As the father of four small children, I am very optimistic about the long-term outlook for the American economy and our American way of life. I am equally pessimistic about what could happen if we mismanage the banking crisis over the next few months—although, so far, I am impressed by the actions taken by our current administration since the crisis emerged on September 15, 2008.

I am also gravely concerned about the impact of this crisis on the people of other nations, particularly those nations that do not yet have the stability, strength, and faith of the people of the United States. The people of the world need American leadership today more than at any time since World War II.

God bless you.
God bless America.
God bless us all.

Paul Zane Pilzer