Bailout of Germany’s Hypo Real Estate: A bottomless pit

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Hypo Real Estate (HRE) is an international property lender and the second largest mortgage lender in Germany. The firm has repeatedly applied for and received state support and guaranties, which have now reached over 100 billion euros.

An initial bailout-package of over 35 billion euros was authorised at the end of September last year, and this was then topped with a further 50 billion at the beginning of October. Since then, HRE has reported new “holes” in its balance sheet every month, and the German government has repeatedly propped the bank up.

Despite all these measures, the HRE continues to report an urgent need for financial help. According to a report in the *Frankfurter Allgemeine Zeitung*, further state guaranties in the sum of 20 billion euros will be necessary in the coming week. When the HRE presents its annual statement of accounts on 31st March, it is expected to show the need for a further 10 billion euros just to fulfill the statutory minimum equity capital requirements.

No one seems to be able to say exactly how high HRE’s mountain of debt actually is at the moment. While up to now speculation pegged the sum at about 400 billion euros, on Wednesday, the *Hannoversche Allgemeine* reported insiders and experts from the Federal Parliament’s Lower House as saying that the Munich-based concern in reality has credit and derivates debt amounting to a trillion euros, of which a large part derives from businesses that do not appear in the official balance sheet.

German Finance Minister Peer Steinbrück (Social Democratic Party--SPD) and Chancellor Angela Merkel (Christian Democratic Union--CDU) have justified state help for the HRE by saying that the property lender is a “systemically relevant” institution that cannot be allowed to fail, because its demise would undermine the entire German economy. Any collapse of the HRE would have the equivalent international impact of the bankruptcy last September of Lehman Brothers.

For years securities have been seen as safe investments. For that reason, they often have been used to underpin life insurance and pension funds. With a market share of about 20 percent—an estimated total of 900 billion euros—HRE is one of the leading players in the German securities market. The German government fears that the collapse of HRE could bring the entire securities market crashing down with it, with unforeseeable consequences. However, the Consortium of Securities Bankers deny that such a danger exists.

Steinbrück and Merkel have also emphasised that state assistance for HRE consists solely of securities that would only be used in the case of actual insolvency, and of capital investment, that could perhaps later be sold again at a profit. However, it is becoming more and more obvious that the federal treasury is actually taking on full liability.

To understand the extent of the sums involved one can compare them to Germany’s domestic budget. The guaranties that have already been given to HRE represent one third of the annual state expenditure of 290 billion euros. These subsidies are nearly as big as the largest single item of state expenditure—unemployment and social welfare, which amounts to 124 billion euros.

If HRE goes bankrupt, the federal government will be liable for its cash infusions and guarantees. In order to pay off the liability for more than 100 billion euros, it would have to drastically increase government borrowing and at the same time make further cuts in public spending on social support and welfare.

On the other hand, if the government continues to feed HRE with ever-greater sums of money, in order to stop it from going insolvent, it will end up being hostage to the bank. “Unfortunately, no-one knows what is more dangerous: letting the HRE go bust, or keeping it half-alive with constant money transfusions,” commented the *Süddeutsche Zeitung.*

The government is proceeding along the latter path. The Cabinet has put forward an “emergency takeover bill” which will facilitate further cash infusions into HRE. This bill is expected to be approved by the Bundestag (Federal Parliament) and Bundesrat (Federal Assembly) no later than April 3 this year.

Finance Minister Steinbrück justified these measures by saying that the nationalization of the shareholders had nothing to do with nationalisation as such, but with the safeguarding of public funds. “We are guaranteeing a huge sum of money, but we are not taking over a single share. If the government becomes the owner, the bank’s refinancing and capital options will considerably improve. They will then profit from the high creditworthiness of the federal government,” he said. The aim was to promote a “viable business model”, so that the HRE bank could quickly be sold into private hands again. Chancellor Merkel justified the need for such an nationalization by declaring “it is internationally agreed that a bank cannot be allowed to fail if it will bring others down with it."

The nationalization plan was immediately greeted with protests from the parliamentary opposition parties, the media, and from within the ranks of the grand coalition itself, who all contested the state takeover of a bank as unthinkable in Germany.

From the Union itself, a number of top politicians reacted immediately with words of warning. The new minister for Economic Affairs, Karl-Theodor zu Guttenberg, said last weekend: "Ludwig Erhard would be turning in his grave." For the Christian Social Union (CSU) leader, Horst Seehofer, the idea is "very difficult to stomach." And the free market Free Democratic Party, (FDP) leader Guido Westerwelle exclaimed: "We live in a free trade economy, not a socialist state!" Scarcely any of them were prepared to use the term "nationalization" without connecting it to the phrase "as a measure of last resort".

The reality is that the temporary state takeover of the HRE has absolutely nothing to do with socialist nationalisation. Its aim is not the abolition of capitalism, but its salvation.

The nationalisation will not serve to "secure public funds," but will burden the working class with additional financial sacrifices. The massively indebted bank is to be temporarily nationalized, in order to revive it with taxpayers' money before returning it to the private sector.

The majority of commentators are well aware of this. Dorothea Schäfer from the German Institute for Economic Research (DIW) has described the criticisms of the planned nationalisation as "perverse". She declared that the state was simply taking over shares in a "virtually insolvent company" because, in this particular case, state intervention was the only possible way to rescue the "systemically important" institution. She compared the government involvement to the emergency actions of firefighters. "Whoever complains that firefighters have to break down front doors as part of their job just hasn't understood the urgency of the situation", she said.

Heribert Prantl, who is in favour of the nationalisation, has written in the *Süddeutsche Zeitung:* "This state takeover is in no way a socially revolutionary measure, it is not even an instrument of social reform." Nor is it a means of increasing state assets. The state is laying its hands on a central body of capitalism, "not to systematically change it," but to help it survive.

While every German citizen is now liable for HRE to the tune of 1,200 euros per head, not a single one of the financial speculators, main shareholders or board members of HRE has been held accountable for their corrupt and irresponsible practices.

The HRE business model was based on securing long-term loans with short-term loans. In order to avoid the supervisory control of the financial and treasury inspectors, HRE devolved part of its activities to its daughter firm Depfa in Ireland. The outbreak of the financial crisis shattered these practices. Because of the credit crunch, in which banks have largely ceased lending to each other, HRE can now only survive in the short term and have a chance to refinance itself with the help of billions of euros in guarantees from the German government.

Despite all this, the German government still considers itself obliged to do what the banks and the financial elite command them. Their "emergency takeover" bill proposes to legalise enforced nationalisation by the end of June, if the shareholders do not voluntarily accept the current state takeover deal. The expropriated shareholders would then receive as compensation the average stock market price for their shares from the two weeks prior to the nationalization. Should the bank later be re-privatised, which they expect to happen soon, the deal offers the former shareholders first option to re-purchase the same shares.

The American investor group J.C. Flowers, which is HRE's majority shareholder with 24 percent of all shares, has offered no serious objection to the planned nationalization. In a letter to the federal government, the board of the group declared that they also agree with the government's aim of taking on a majority share in HRE of 75 percent plus one share. Only the amount of compensation for the concerned shareholders was "in our view not acceptable".

In June 2008, J.C. Flowers became majority shareholder when it bought a billion euros' worth of stakes in HRE at the price of 22.50 euros per share. The current value of these shares – €1.60 each – has melted 60 billion euros away from their portfolio's value. Should the bank go bust, the shares would be worth absolutely nothing. So now J.C. Flowers wants the state to make up for their speculative losses.

But investors are trying their luck at pushing the price higher. They are threatening to contest enforced nationalisation with long-drawn-out legal processes and are demanding compensation for the voluntary surrender of their shares—compensation that, at three Euros per share, is double their current stock market value.

The nationalisation envisaged by the German government is nothing more than an effort to rescue the bank at a cost to the German people of billions of euros. But these government actions will neither halt nor solve the financial and economic crisis. They will leave untouched the basic interests of the ruling class, which are rooted in the private ownership of capital and control over the financial system as a whole.