

Can credit default swaps be abolished?

By [Washington's Blog](#)

Global Research, June 30, 2009

washingtomblog.com 28 June 2009

Region: [USA](#)

Theme: [Global Economy](#)

Tim Geithner was asked whether credit default swaps should be abolished altogether.

Remember, the Nobel economist who helped create the pricing formulas for CDS [said](#) the CDS are so dangerous that existing over-the-counter contracts should be voided:

The “solution is really to blow up or burn the OTC market, the CDSs and swaps and structured products, and let us start over,” he said, referring to credit-default swaps and other complex securities that are traded off exchanges. “One way to do that, through the auspices of regulators or the banking commissioners, is to try to close all contracts at mid-market prices.”

Many other economists agree.

But in a question and answer session, Tim Geithner said we need CDS for financial “creativity” and “innovation”:

Question: During questioning before Congress you were asked why exotic investment instruments like credit default swaps shouldn't just be done away with. You responded that you did not want to stifle “creativity” in the financial markets. Why do we want a “creative” financial market? - Anonymous

Answer: We want a creative financial market because a creative economy requires it—the innovations generated by our markets and institutions help to make our economy the most vibrant and flexible in the world. The new products, services and capital, they produce are exactly what help turn a new idea into the next big company. Overall, we do not believe that you can build a system based on banning individual products—our core challenge is ensuring we have a system that has a proper balance between innovation on the one hand and consumer protection on the other. We propose keeping the system safe for innovation by having stronger protections against risk in CDS and other derivative markets with stronger capital buffers, greater disclosure so investors and consumers can make more informed financial decisions, and a system that is better able to evolve as innovation advances and the structure of the financial system changes.

Here's the actual exchange (page 8)

Of course, the U.S. economy is not “the most vibrant and flexible in the world”. It is the most broke in the world.

But is Geithner right that financial “creativity” and “innovation” are good things?

No.

The Canadian banking system is the world's most stable banking system [precisely because it is boring](#) instead of innovative.

As Paul Krugman [writes](#) that banking has to be made boring again, to prevent the kinds of results which came from high -flying finance in the 1920's (the Great Depression) and late 1990s early 2000s (the current melt down). Krugman also notes:

Part of the problem is that boring banking would mean poorer bankers, and the financial industry still has a lot of friends in high places. But it's also a matter of ideology: Despite everything that has happened, most people in positions of power still associate fancy finance with economic progress.

Indeed, the most "boring" type of banking system imaginable would be to take the power to create credit away from the private banking giants and give it back to the government, as the [Founding Fathers originally intended](#). By abandoning the "creativity" and "innovation" which has allowed the banksters to charge trillions in unnecessary interest fees to the American people bankrupt our nation and drive us into a Depression, we can get back to the "pursuit of happiness" which our forefathers fought and died for and which the Declaration of Independence promises.

See also [this](#).

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