

Financial Meltdown: The TARP Dog and Pony Show

With no clear strategy, the new bank-rescue plan offers only more uncertainty

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Treasury Secretary Timothy Geithner's long-awaited plan for rescuing the banks left people even more confused about the Obama administration's agenda than they had been before the announcement. This is best demonstrated by the plunge in the market, including bank stocks, that immediately followed. While it is generally foolish to assess the merits of a policy based on the market's response, it is a safe bet that if the plan were the unambiguous bonanza for the banks that many of us feared, bank stocks would rally based on their good fortune. At this point, we cannot be sure that it is not a giveaway, but apparently the banks do not seem to think that it is. This is one of those cases where everything will depend on the details, which we have not yet seen.

The one program that Geithner did outline with some clarity was a plan to buy up newly issued investment-grade securities backed up by car loans, credit-card debt, and student loans. This plan would expand a Federal Reserve Board initiative, which has not yet been started, from \$100 billion to \$1 trillion.

There is nothing obviously wrong with this proposal. It will help to extend credit in these markets, although people with questionable credit histories or who have recently lost their jobs will still have difficulty qualifying for loans. One issue that is not clear is whether there will be public disclosure of the assets purchased under this program. The Fed had not been in the practice of disclosing the details of its activities under its other programs. Either the Fed will have to change its practice, or Geithner's commitment to openness is not as great as claimed.

This brings us to the other program that Geithner only vaguely outlined. He said that he wanted to partner with private firms to arrange for purchases of the banks' bad assets. The Treasury would provide guarantees that would limit the losses that private firms would incur, as it has done with hundreds of billions of assets held by Citigroup, J.P. Morgan, and Bank of America.

In principle, government guarantees could make bad assets attractive to private investors. The problem is that the guarantees are in effect a subsidy to the banks, since they add an enormous amount of value to their assets. It may be difficult to know the full extent of the subsidy, since many of the prospective buyers of the banks' junk are likely to be private-equity funds and hedge funds, both of whom have very little by way of disclosure requirements.

Fortunately, we don't have to follow the individual trades to know whether the taxpayers are being ripped off. We just need to ask some more basic questions like "How much will this

thing cost?" If the answer is anywhere much more than zero — as Geithner suggested it will be — and we still see that bank stocks carry significant value and bank executives continue to hold on to their high-paying jobs, then we will know that we have been had.

The basic point is extremely simple. We have a large number of bankrupt banks. We have a public interest in keeping the banks functioning, but we have zero public interest in giving taxpayer dollars to bank shareholders or to the executives that wrecked the banks they ran.

Geithner can design as complex a dog and pony show as he wants, but if his plan takes up hundreds of billions of taxpayer dollars and does not involve wiping out the shareholders and sending the bank executives packing, then he has ripped us off.

Chalk it up to business as usual.

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