GlobalResearch
Center for Research on Globalization

Geithner’s Debut: “Not Ready for Prime Time”

By Mike Whitney
Global Research, February 14, 2009
Information Clearing House 14 February 2009

Region: USA
Theme: Global Economy

Tuesday was Treasury Secretary Timothy Geithner’s coming out party. He was supposed to outline Obama’s Financial Stability Plan to the Senate Banking Committee. Wall Street was looking for clarity, but it didn’t get it. Instead, they got 25 minutes of political posturing and blather. The markets went into freefall. By the end of the day, the Dow was down 382 points. It was a complete fiasco.

Geithner is a smart man. He knows what Wall Street wants. They want a plan and they want the details. They don’t want more gibberish. He knew that he’d get hammered if he didn’t produce a workable scheme for fixing the banks, but he went ahead anyway figuring he could dazzle his audience with his brilliance. It didn’t work. The markets plummeted and the pundits wrote him off as “not ready for prime time”. Now his credibility is shattered just three weeks into the new administration. Why did he do it?

Most people who’ve been following the financial crisis know what needs to be done. It’s no secret. The insolvent banks have to be nationalized. They have to be taken over by the FDIC, the shareholders have to be wiped out, bondholders have to take a haircut, management has to be replaced and the bad assets have to be written down. There’s no point in throwing public money down a rathole just to keep zombie banks on life support.

Nobel prize winning economist Joseph Stiglitz sums it up like this:

“The fact of the matter is, the banks are in very bad shape. The U.S. government has poured in hundreds of billions of dollars to very little effect. It is very clear that the banks have failed. American citizens have become majority owners in a very large number of the major banks. But they have no control. Any system where there is a separation of ownership and control is a recipe for disaster. Nationalization is the only answer. These banks are effectively bankrupt.” (Deutsche Welle)

Economist James Galbraith says the same thing in an interview on Democracy Now with Amy Goodman:

“I think it’s fair to conclude that the large banks, which the Treasury is trying very hard to protect, cannot in fact be protected, that they are in fact insolvent, and that the proper approach for dealing with them is for the Federal Deposit Insurance Corporation to move in and take the steps that the FDIC normally takes when dealing with insolvent banks.

And the sooner that you get to that and the sooner that you take these steps, which every administration, including the Bush administration, actually took in certain cases—replacing the management, making the risk capital take the first loss, reorganizing the institution, guaranteeing the deposits so that there isn't a run, reopening the bank under new management so that it can begin to function again as it should have all along as a normal bank—the sooner you get to that, the more quickly you'll work through the crisis.

The more you delay and the more you try to essentially prop up an institution whose books have already been poisoned, in effect, by this—the practices of the past few years, the longer it will take before the credit markets begin to function again. And as I said before, the functioning of the credit markets is absolutely essential to the success of the larger package, of the stimulus package and everything else, in beginning to revive the economy."

Most of the economists say one thing while the bankers say the exact opposite. It's no surprise; they want to save their own skin. But bailing out the banks again is not in the public interest.

Most of the bad paper and non-performing loans appear to be concentrated in the very largest banks. By some estimates Citigroup, Bank of America, JP Morgan-Chase and Wells Fargo are holding two-thirds of all the toxic mortgage-backed paper. Therein lies the problem. These banking Goliaths have powerful constituencies and substantial political power. Keep in mind, the Obama campaign received over $10 million in contributions from Wall Street, the largest contributors by far. This suggests that Timothy Geithner is point-man for the banksters and his job is to fend off nationalization. Geithner admitted as much on Tuesday in an interview with Brian Williams when he said that he intended to "keep the system in private hands". If that's the case, then the taxpayer better get ready for a real shellacking, because it will take many trillions to keep these dinosaurs from extinction.

An interview in International Risk Analysis with Josh Rosner of Graham Fisher & Co sheds a little light on the backroom goings on during this charade:

Rosner: "I am hearing very clearly from within the regulatory community that it is their primary concern that whatever they are planning is predicated on the notion that we must keep the large banks alive. But if we start off with saving the big banks as the point of departure, then there is no way we can marry that to an efficient or effective proposal. Lets define the solution based first on what is workable not by tying a hand behind our back with preconceptions."

Rosner explains the political dynamic which is driving the decision making:

Rosner: "I think this argument has less to with Lehman and more to do with the fact that the Fed of New York and the Board (of Governors) have always benefited from the failure of small institutions and the absorption of those assets by the big banks. There is no way that they can stomach seeing their regulatory power dissipated by those institutions now being broken up and sold. Perhaps we have to go back to the question of whether it makes sense for the Fed to be a regulator as well as a central bank."

The IRA (Institutional Risk Analysis): "Especially to investors outside of the New York district and even outside the Fed's immediate jurisdiction, to foreign investors. But whether anyone at the Fed or Treasury likes it or not, we are talking about the absorption by the US Treasury of at least half a trillion in losses for the top three banks in the next 12-18 months if an FDIC resolution is to be avoided.....This issue of resolving the larger banks has been a political issue going back to Paul Volcker's day. Democracy is inefficient." (The Big Banks vs. America: A Roundtable with David Kotok and Josh Rosner http://us1.institutionalriskanalytics.com/pub/IRAstory.asp?tag=337

The problem goes well beyond the failed banks. The issue can't be resolved because important clients of the banking lobby have a stranglehold on the Dept of Treasury and are sabotaging the rescue operation. In fact, it's looking more and more like Obama's election was part of a quid pro quo to ensure that Geithner, Summers and the other "big bank" loyalists would continue to control the levers of political power during the stormy years ahead, otherwise they would do what is necessary and and shut them down now.

GEITHNER"S SPEECH

Geithner knew exactly what he had to say on Tuesday, but hemmed and hawed and avoided the central issues like the plague. He provided no new details on how the government planned to remove the illiquid assets that are fouling the banks' balance sheets nor did he explain how he would determine the value of these assets. It is shocking to realize that the financial crisis started 19 months ago (when two Bear Stearns hedge funds defaulted) and still, no one has any idea of what these assets are really worth. Price discovery is basic to any functioning market but, in this case, fear has carried the day. Everyone involved is terrified that trillions of dollars of assets will turn out to be worthless.

Geithner employed the same obfuscating techniques as Alan Greenspan. He tried to affect the look of a man who was deeply concerned while rattling off well-rehearsed statements that revealed absolutely nothing about his real intentions.

"I completely understand the desire for details and commitments," Geithner opined with heartfelt sincerity, "but we're going to do this carefully so we don't put ourselves in the position again….This is the beginning of the process of consultation." The there was this gem worthy of Maestro himself, "We are exploring a range of different structures" to deal with precisely that issue.

Right.

Most of the critics believe that Geithner is in over his head, but that's probably not the case. More likely, he has a plan but wants to keep the public in the dark. After all, there's no graceful way to tell people that they are about to get shafted for another $2 trillion to keep the larder on Wall Street full of Dom Perignon and chocolate truffles.

One thing Geithner will insist on is that the Treasury and the Fed remain the final arbiters of "who is solvent and who is not" as regards the big banks. That should be Sheila Bair's job. As the head of the FDIC, Bair is the regulator who should be in charge of checking capital reserves and closing underwater banks. But, apparently, Bair has been crowded out for political reasons. Geithner and his insider friends are calling the shots.

Geithner announced that Treasury would be putting together a new "public-private investment fund" to try to attract private capital to assist the government in purchasing some of the higher-rated assets the banks are trying to unload. The details are still sketchy, but it sounds a lot like Henry Paulson's Super SIV (structured investment vehicle) which provided a spot for the banks to dump their off-balance sheets garbage in one "government approved" SIV. Of course, the idea failed because, by then, investors were already skittish about buying complex, structured investments. Even so, Paulson's credibility took a real beating. He was seen as using his office to peddle dodgy bonds for his friends. Geithner won't make the same mistake. He'll take the high-road and entice the banks and hedge funds into buying the distressed MBS by providing government guarantees and subsidies similar to the perks in the Merrill Lynch-Lone Star transaction. In that deal, Merrill offloaded \$31 billion in toxic CDOs for \$.22 on the dollar and provided 75 percent of the financing. It was a sweetheart deal from the get-go and Geithner will undoubtedly duplicate it to get rid of the junk at no risk to the buyer. That will help fatten the bottom line of the teetering banking fraternity.

Geithner's financial rescue plan includes \$500 billion to \$1 trillion for the Fed's Term Asset-Backed Securities Loan Facility (TALF). This will provide additional funds for institutions that finance pools of car loans, student loans, credit card debt etc. The securitization of consumer debt, which broke down 19 months ago when the crisis began, has resulted in an unprecedented slump that's put the world economy in a tailspin. Securitization has been Wall Street's golden goose. It's a reliable way to maximize leverage on smaller and smaller slices of capital. As borrowing increases, asset prices rise, making the system more and more unstable. When the bubble finally bursts; the tremors ripple through the real economy sending asset values crashing, equities markets plunging, and unemployment skyrocketing.

In his speech Geithner admitted that, "In our financial system, 40 percent of consumer lending has historically been available because people buy loans, put them together and sell them. Because this vital source of lending has frozen up, no plan will be successful unless it helps restart securitization markets for sound loans made to consumers and businesses — large and small."

40 percent! Think about that. Nearly half the credit pumped into the economy comes from securitization.

In other words, the banks ARE lending; it's just that Wall Street's credit-generating mechanism is kaput. That's why the fall-off in auto sales, consumer spending and foreign trade has been so dramatic, unlike anything anyone has ever seen before. Wall Street's credit model is broken. Shouldn't there at least be public hearings before Geithner and Bernanke put Humpty together again and we resume the same tragic boom and bust cycle? There has to be another way.

Credit production should never be in the hands of speculators. It's too dangerous. That's why the banks need to be strictly regulated, because the power to create credit is "more dangerous than standing armies".

According to the UK Telegraph:

"The past five quarters have seen 40pc of the world's wealth destroyed and business leaders expect the global economic crisis can only get worse."

Once again; 40 percent. The global economy is contracting to accommodate the new reality of less debt-fueled expansion. Wall Street (understandably) is looking for its next bubble, just like Geithner. But deflation follows its own inescapable logic, too. The excess leverage and unsustainable credit that was produced via complex debt instruments, derivatives contracts, and structured investments is being purged from the system causing a generalized shrinking throughout the economy. There's no need for an oversized financial system; business activity is slowing, investment and trade are dwindling, and consumers are hunkering down.

Even in the best of times it would be difficult for Geithner and Co to achieve their goal of saving the big banks. But given the state of the economy–the wobbly dollar, falling tax revenues, the enormous deficits, rising unemployment, the erosion of household balance sheets and the massive system-wide contraction–a multi trillion dollar bailout that leaves the banks in private hands is just not realistic. Geithner will not succeed. Every attempt to save the banks will be met with greater and greater public resistance and rage. The banks that are underwater need to be put out of their misery and nationalized.