Obama's Busted Bank Bailout

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Author's Note:

Parts of the following article were published in the April issue of 'Z' Magazine. It was written in February, after the US Treasury Secretary, Geithner, announced his initial draft bailout program. That initial program was met with widespread rejection by bankers, investors, and the business press. It was revised significantly by Geithner on March 23. What follows below is an expanded version of the article written by the author that appears in the April issue of 'Z'. The expanded integrates Geithner's revised March 23 PPIP proposals into the analysis of the Obama Administration's shifting bank bailout strategy.

This revised article notes the strategic significance of the Geithner March 23 changes for bailing out the banks, how those changes represent a major shift in strategy, and the emerging longer term consequences of the strategy shift).

In February 2009, economic data across the board revealed an accelerating decline of the U.S. economy, both in its financial and non-financial elements:

Gross domestic product (GDP) data for the U.S. economy for the fourth quarter 2008 was fundamentally revised downward, showing the US economy had contracted by more than 6.2%. The economy's contraction for the first three months of 2009 will almost certainly show an even faster decline.

Unemployment levels from November 2008 through February 2009 show an official rise in joblessness of nearly two million, according to official US government data. When properly adjusted, however, to include the six million new underemployed since the recession began plus discouraged and other workers not recorded in the official data, the actual U.S. unemployment has risen by at minimum three million since last November. Properly calculated, there are now more than thirteen million unemployed in the U.S. By year-end 2009 the unemployed will very likely exceed twenty million.

Meanwhile, in January-February 2009 the balance sheets of banking and finance giants like Citigroup, Bank of America, AIG, Fannie Mae, and more than 250 regional banks now on the FDIC's official danger list, continued to deteriorate badly. As the financial crisis continues to drag on unresolved, a rapidly growing number of once financially sound banks and financial institutions enter the growing ranks of 'zombies' (i.e. banks in name only and not performing the functions of banks in fact), while previous 'zombies' become virtual 'cadavers'—many of the latter the top twenty largest banks in the U.S.

In an attempt to check and stabilize the growing real and financial decline the new Obama administration proposed a four-part recovery program. The first part was the $787 billion fiscal stimulus bill passed in February. Of equal import to the fiscal stimulus package were three proposals to try to stabilize the financial system. These include the so-called 'PPIF' (Public-Private Investment Fund), the 'TALF' (Term Asset Backed Securities Lending Facility), and the 'HASP' (Homeowner Affordability and Stability Plan).

20 Million Jobless vs. $3 Trillion More for the Banks

The Obama $787 billion fiscal stimulus bill designed to resurrect the non-financial economy—now in virtual freefall—provides only $180 billion in total spending in 2009. Only $26 billion of that is allocated for job spending, according to the U.S. Congressional Budget Office. New jobs created in 2009, given that level of spending, will result in new job creation in the low hundred thousands at best, while simultaneously a minimum of 5-7 million new unemployed will be added to the jobless rolls in 2009. That's less than a half-million new jobs compared to thirteen million new unemployed since the current Epic Recession began in late 2007.

One thing is thus quite clear about the Obama fiscal stimulus plan: it is not a jobs creation program. It is not designed to create anything near the number of jobs that have been, are currently being, and will soon continue to be, lost.

That key fact means the Obama stimulus package will not appreciably slow the collapse of consumer spending currently underway in the U.S. Job loss is at present the main driver of that collapse, along with other forces previously driving the decline of consumption—i.e. collapse of 401k and defined pension plans, freefall in stock and home owner equity, and sharp reductions in hours and earnings for the 90 million non-supervisory and production worker in the U.S. still with jobs.

Constituting more than 70% of the US economy's GDP, consumption has literally fallen off a cliff since October 2008. For the first time ever in data collecting history, consumption declined absolutely in the US the past year while the index for future consumer spending hit a postwar low at 35 out of 100. Business spending has fared no better. Business plans for capital expenditures show a decline of more than one third. At the same time, exports and world trade are contracting at the fastest rate in decades. There's nothing left but aggressive government job creation action to stem the decline. But that action is not forthcoming in the recent stimulus bill.

What the $787 billion represents is a stop-gap program to try to offset in part the magnitude of consumption collapse now underway. It is not a spending program to turn around the economy. Fully 38% of the stimulus is in the form of 'Aid' measures to offset jobs loss income with unemployment, food stamps, medical costs assistance, and various grants to state and local government. While worthy and necessary, it will not create any jobs. Another 38% of the stimulus is targeted for tax cuts. They will have no net effect on consumption. In fact, as many economists now note, the 'multiplier effect' of the tax cuts may actually be negative—that is the tax cuts will produce spending in an amount actually less than the value of the cuts themselves. That leaves only 24% remaining that represents spending on potential jobs projects. However, the vast majority of the jobs that might be created will be longer term, capital intensive, infrastructure
jobs in alternative energy and public works.

Both the magnitude of the direct spending on jobs creation ($26 billion in 2009 and less than $200 billion over the life of the package), as well as the composition of the jobs creation, are grossly deficient. Measured in terms of jobs, consumption, and general economic recovery, the Stimulus package represents “too little too late”. The likelihood is therefore high that a second stimulus package will be necessary within the next twelve months.

In sharp contrast to the paltry spending in 2009 on jobs is the virtually unlimited, rapidly disbursed, and open-ended flow of funds now underway from U.S. government coffers into the banks and other financial and quasi-financial institutions. This uninhibited flow of funding includes a second $200 billion injection for Fannie Mae/Freddie Mac now that they ran out of the first $200 given them last August; another $60 billion for AIG, American Insurance Group, bringing its total to more than $200 billion to date; tens of billions more for Citigroup and Bank of America; hundreds of billions more for brokers of Commercial Paper and Money Market Funds, for foreign banks holding US securities, for credit card company giants like American Express, for Auto companies, plus a long list of others waiting in the wings. A grand total of at least $3 trillion thus far—and rising—disseminated to the banks, the broader financial sector, and beyond. That includes
$1 trillion designated to the PPIF for buying of bank ‘bad assets’; another $1 trillion to ‘TALF’for resurrecting the ‘shadow banking’ system of hedge funds, private equity firms, and the like—i.e. the guys who gave us runaway speculation in securitized assets and the excess leveraging and debt run-up that underlies the origins of today’s continuing collapse of the financial system; and another $275 billion to ‘HASP’, which will be used primarily to subsidize mortgage lenders, servicers, and investors.

What follows is an assessment and critique of these three elements of Obama’s bank-finance bailout, showing why the bank bailout is doomed to fail, why it won’t succeed in stabilizing the financial system, and why a totally new kind of restructured banking system is required before the financial system can stabilize and the real economy halt its accelerating decline.

Public-Private Investment Fund (PPIF)

The PPIF is the ‘Son of TARP’. It is the inheritor of the failed TARP program launched in September 2008. Then Secretary of the Treasury, Paulson, panicked the U.S. Congress into granting him a check worth $700 billion in order to buy the ‘bad assets’ on the balance sheets of banks. Cleaning up the bad assets was necessary, he argued, in order to get the banks to begin lending again—both to homeowners and the mortgage markets and to general business.

Paulson was given the money and then did nothing about buying bad assets. He instead threw $125 billion at the 9 biggest banks, followed by another roughly $125 billion to scores of regional and smaller banks. None of it purchased bad assets. Another $80 billion or so went to AIG in several installments. Tens of billions more to Citigroup. Nearly $20 billion to auto companies. Further billions were dissipated here and there, so that by February 2009 less than $190 billion of the $700 remained. None of it expended to purchase ‘bad assets’.

The reason why it was never used to sop up the bad assets on bank balance sheets are the same reason why Paulson’s successor at the Treasury under Obama, Tim Geithner, will also fail in cleaning up the bad assets with the PPIF, son of TARP. Because the banks wont sell them at anything resembling market prices and the true value of the ‘bad assets’ on their books.

Paulson faced the dilemma of selling the assets at their market price, which was virtually worthless. Since the banks were keeping the assets on their books at inflated, above market price, they had no incentive to sell them at market prices and register even greater losses in doing so. They wanted Paulson to buy them at above market price. If he did, however, he would be charged with providing a windfall profit to the banks purchasing the assets well above what they were worth. So he did nothing. Or next to nothing. He used them to purchase preferred stock in the banks, in the hope that it would at least partially close up the 'black hole' on bank balance sheets that was ever-widening as the value of housing prices, mortgage bonds, and other securities continued to collapse in value as housing prices continued to fall. The fall in housing prices was in turn due to the flood of supply of houses coming onto the market as a result of foreclosures.

In other words, pumping money into the banks via TARP only served to temporarily plug in part an ever-growing hole driven by housing value collapse which the TARP did not in any way address. TARP addressed the symptom of collapsing balance sheets and not the cause of those collapsing balance sheets. In fact, all the measures of the Treasury and Federal Reserve since the crisis began in 2007 share the common strategic error of throwing liquidity (read: taxpayer money) at the balance sheet hole while ignoring solutions to stop the cause of the hole's constant expansion. To put it all another way, it was politically more correct for government friends of bankers to help repeatedly, time and again, shore up bank balance sheets, even if temporarily, instead of helping homeowners avoid foreclosure in the millions. Unfortunately, the latter was and remains the solution, while the former a failed treatment of the symptom.

The PPIF and Geithner face the same dilemma. Namely, how to get the banks that are now 'on strike' and refusing to lend because they don't have the assets and reserves to lend, to begin doing so. Geithner's plan is TARP with a twist. The idea is to subsidize the price of the bad assets at government expense, and by doing so provide an incentive to both the banks to sell and investors to buy the bad assets at well above their true value, low, market price.

PPIF Becomes PPIP After Bankers-Investors Resist

In his original version of Geithner's PPIF announced in February, the program was designed to provide a subsidy to banks (sellers) and investors (buyers) as follows: The Treasury would put in what remains of TARP ($100 billion) plus additional money up to $1 trillion, which would likely expand eventually well beyond $1 trillion. The trillion was to be used to pay the banks the difference between the true low market price and whatever the new price might be. In addition, the government would pay the investors another amount at taxpayer expense to incent them in turn to purchase at a price that is above the low market true value of the assets. An auction like event would be held. In short, whatever the seller (banks) and buyer (investors) end up with as a price, the Government will subsidize the difference for both. That would, theoretically, establish a new market price at which subsequent assets might be sold. Thus the dilemma faced by Paulson—no market price acceptable to investor-buyers or bank-sellers—would be resolved.

This first Geithner plan was attacked vigorously by bankers, investors, and the general business press; the stock market plunged accordingly. Geithner thereafter went back to the drawing table for several weeks to revise the plan.

As he was rewriting his original proposals several important events occurred: first, a firestorm over bank bonuses emerged in the interim, provoked by the leaking of information that AIG, the insurance giant, more than 80% owned by the government as a result of a series of direct bailouts since last October amounting to more than $170 billion, had recently paid bonuses of billions to its same traders that brought the company down in the first place.

A second major interim development was the Congressional Budget Office announced in March that the US budget deficits would range from $1.2 to $1.8 trillion this coming year. This arose at a time during which Obama also was faced with increasing resistance in Congress to the passage of his general budget, which promised to add still hundreds of billions of dollars more to the deficit.

All this meant growing awareness about the costs of more bank bailouts to the Treasury and annual budget deficit. Growing pressures on the deficit meant that financing PPIP directly from the Treasury would add trillions more immediately to the deficit. Another way, bypassing the Treasury with 'smoke and mirrors', had to be found.

Complicating the 'interim' situation even further, banker-investor resistance was rising to the increasing likelihood that Congress was about to levy higher taxes on banker-investor bonuses and compensation. Their response to the Obama administration was to threaten not to participate in the PPIP if their income and capital gains taxes were 'rolled back' to 1980 levels of 70% tax rates, as Congress was threatening.

Geithner then released on March 23 his 'revised' formula for government subsidizing of bankers and investors to get them to buy and sell 'bad assets'. This new formula did not rely on direct price subsidization, as under the initial Geithner plan, but instead provided virtually unlimited government funds at near zero cost to investors-speculators (e.g. the hedge funds, private equity firms, mutual funds, wealthy investors, etc.) with which to buy the 'bad assets'. The 'bad assets' come in two basic forms: bad bank loans and bad toxic securities (the latter based on subprime mortgages, asset backed commercial paper based CDOs, securitized auto, credit card, and student loans, etc.)
The free loans available to buy both forms of 'bad assets' were also now provided as 'non-recourse' according to the new Geithner plan. That meant if the bad assets purchased fell in value after purchase, the borrower (investor-speculators) did not have to pay them back. Furthermore, the borrower did not have to put up any collateral of his own for the government 'free money' loan.

This was an even better arrangement (read: more profitable) for capitalist investors (hedge funds, private equity, etc.). Under the initial arrangement announced by Geither in February, despite the government paying for part of the purchase price for the bad assets, the borrower (speculator-investors) still had to put up their money to pay for a good part of the total price of the purchase. Now they had to put up much less, at most one-sixth, and could borrow the rest from the government at no cost and no risk whatsoever.

The revised Geithner plan was also a better arrangement for the Treasury. A new method of financing meant there would not be as great a 'hit' on the budget directly. As noted above, resistance to greater budget deficits was rising rapidly in Congress and thus also to additional funding for any kind of increase in TARP or Treasury direct funding of bailouts . A new approach had to be worked out. That new arrangement, contained in Geithner's revised PPIP, meant subsidies for financing 'bad loans' assets to borrowers(investors) and sellers (bankers) will not come directly from the Treasury, but from the FDIC, the Federal Deposit

Insurance Company. Likewise, subsidies for financing the 'bad securities' assets will come directly from the Federal Reserve.

The second, revised Geithner plan for PPIP thus represents a major strategic shift by the Obama team with regard to bank bailouts. It is a shift toward having the bulk, perhaps eventually all, the bank bailout funding coming from the Federal Reserve and not the Treasury-Congress. That means having the Fed finance the future lion's share of bank bailouts by monetizing the debt—that is, by printing new Federal Reserve Bonds.

It appears in Geithner's March 23 revised announcement, only the $100 billion left of TARP I funds held by the Treasury will be used to start the PPIP subsidies. Talk is that the FDIC may get another $500 billion from the Treasury or even Congress directly to add to the initial financing. (If so, that will add to the US budget deficit). However, it is more likely that the FDIC will get its funding from the Fed and monetization (or what the Fed calls 'quantitative easing') than directly from Congress, although some may come from Congress initially as well. Statements by the Treasury-Fed on March 23 make it clear, however, that the Federal Reserve will be the major future conduit for FDIC loans to finance and subsidize bank 'bad loans' sales.

The same applies for the Fed when it runs out of Treasuries to sell. Its future source will be the issuance of its own 'Fed Bonds', a new development that will soon begin. Issuing its own bonds amounts to 'quantitative easing', as it is euphemistically called. Which is a term that essentially means 'monetizing' or printing the money.

What all this means is that the Treasury is running out of bonds. If it has to go back to Congress for more authority to issue more bonds that will add dramatically to the budget deficit further. The Treasury is becoming increasingly concerned whether it can get Congressional approval in order to fund further bank bailouts directly. Obama and team have decided therefore, as Plan B, to use the Fed (which doesn't need Congress approval to issue bonds in its own name) to finance the continued multi-trillion bank bailouts. It all amounts to a major strategic shift.

It also means growing pressure on the dollar as the key international currency down the road, as the US government and the Federal Reserve start to print massive amounts of money in the form of new Fed bonds to pay for the bailout. Should it occur it marks the beginning of the end for the dominance of the dollar in global markets. It represents in the meantime a decision to bail out the banks in the short term, at the potential expense of the US dollar as a world currency in the longer term.

It was no coincidence that, within hours of the Geithner revised plan, the Chinese asked for assurances from the US government for the value of the nearly $2 trillion in U.S. government assets China holds at present. And it largely explains why China thereafter followed up with a statement that the capitalist economies should reconsider shifting from dollars to IMF created, so-called 'SDRs' (special drawing rights) as the new currency of the future.

Only $2.5 to 5.0 $ Trillion More to Go

The key question is how much money may the Federal Reserve eventually have to 'print' to bail out the banks? But how much 'bad assets' are out there that must be sold in order to 'clean up' bank balance sheets? The estimates range from $3.6 trillion, according to New

York University professor, Nouriel Roubini, who has been accurately predicting the crisis for more than a year now, to $4 trillion by Fortune magazine, to $6 trillion by Treasury Secretary Geithner in a talk he gave in June 2008 before becoming Secretary. So hang on. There's at least $2.5 to $5 trillion more that taxpayers may have to fork over to the PPIF (now PPIP) before it's over.

The fundamentally flawed premise of the PPIP is that enough investors will enter the market if subsidized to buy that huge amount of bad assets. Or that the banks will agree to sell at the auction determined price. Or that the US government will be able to throw in $2.5 to $5 trillion more.

Another problem is that the root cause of the bad asset price decline will still continue despite PPIP—i.e. the collapsing housing and other asset prices. The $2.5 to $5 trillion is what the bad assets are 'worth' at the moment. Those values can potentially fall further, as in fact they have for the past eighteen months. Housing prices have fallen by 25% to date. Our prediction is that they will fall at least another 20%. Foreclosures are rising, as are delinquencies and defaults. Moreover, they are spreading from subprime to 'Alt-A' to prime mortgage loans and bleeding into the commercial property mortgage markets as well. Homeowners with negative equity will also walk away from properties, throwing more supply on the market and further depressing prices. Then there's the millions more now experiencing unprecedented job loss. They too will add appreciably to the delinquency, default, foreclosure downward pressures on home prices. In short,
bank assets will continue to erode in value. Bad asset totals will rise. Government subsidy costs to banks and investors will consequently have to rise in turn. The fundamental problem is thus still not addressed, let alone resolved.

PPIF-PPIP, son of TARP, is therefore as doomed as its predecessor, TARP I, so long as housing supply continues to rise and housing asset prices continue to fall.

This scenario is not unique or unprecedented. The same happened in the 1930s. Housing prices did not stop falling for more than five years into the Depression, until the Roosevelt administration created the Reconstruction Finance Corp (RFC) and revitalized the Home Owners Loan Corp (HOLC) and went into the mortgage market directly. The RFC arbitrarily determined a price and enforced it. It dissolved bad banks and wrote off their worthless assets. It forced merged those banks that could be saved. The HOLC then directly renegotiated with homeowners, resetting their interest and principal. That finally stabilized the housing market. It quickly produced an equity/stock market resurgence in 1935-36.

TALF as PLAN 'B'

Another problem with PPIF, even in its revised PPIP form, is what is 'Plan B'? What is the back up, the alternative if does not succeed in cleaning up the bad assets from bank balance sheets? How much longer and further will Congress and the public support throwing more money down the ever-widening black hole of bank balance sheets? Enter TALF as Plan B.

TALF is another $1 trillion plan for financial bailouts at taxpayer expense. The idea originated at the Federal Reserve in the closing months of 2008 but was put on hold. Originally funded at $200 billion, Federal Reserve Chairman, Ben Bernanke, held the program back until the Obama administration assumed office.

Unlike the original PPIF, TALF is envisioned as a plan to resurrect the shadow banking system, and the securitized asset markets in particular that collapsed after 2007. Approximately one half of total lending in 2007 ($5.65 trillion) occurred in the securitized markets. This declined to $160 billion in 2008 and to a mere several $billions by early 2009.

The 'shadow banking' system is a network of non-bank financial institutions, most notable of which are the hedge funds, private equity funds, and the like. It was excessive leveraging via securitization that was responsible for much of the speculation driving the subprime and other asset markets until they busted in the summer of 2007. It is thus ironic that the Fed and Treasury now pursue via TALF the resurrection of those same markets and that same shadow banking system.

The idea of TALF is to loan $1 trillion or more to the shadow banking system to have its various institutions (Hedge funds and Private Equity in particular) buy up securitized assets that bundle auto loans, credit card loans, student loans, and even commercial property loans. These latter 'consumer credit' markets are about to collapse and in doing so provide a 'subprime-like' magnitude of losses for financial institutions, including banks. Credit card companies, for example, estimate that defaults on payments will rise from around 4% in early 2009 to 8%-10% or more. TALF is designed to prevent the collapse of these securitized asset backed consumer credit markets.

But TALF represents something even more significant. It represents the lack of confidence on the part of the Obama administration that the regular banking system can lead a lending recovery and thus the restoration of financial market stability. TALF means the administration and the Fed will not wait for the banks to lead the way. The logic of TALF, moreover, is that if the shadow banking system does not rise to the incentive and finance the consumer credit markets, then the Federal Reserve will have to do so itself directly. Should such happen, the Fed will not only evolve from lender of last resort and lender of first resort (since 2007), to lender of primary resort—at least in the consumer credit markets. There is no other alternative. The consumer credit markets cannot be allowed to collapse. To do so would precipitate a bona fide depression given the current state of weakness of the economy and financial system. But if the shadow banking system fails to sufficiently participate, then the Fed must.

This raises the further question whether the hedge and private equity funds can do so. Hedge funds in particular have lost half their value in the past eighteen months due to losses and withdrawals. Once a $2 trillion industry it is now barely $1 trillion. Similar declines have characterized the state of the private equity funds. Furthermore, it is hard to see how the securitized asset markets can be revived, given their 'toxic' reputation and the virtual total collapse of these markets.

Should the Fed have to go it alone that would represent a major shift in the direction of a totally new kind of banking structure. On the other hand, there is also the possibility that TALF and the Fed would serve as a 'holding action' to buy time for the implementation of a 'Swedish Model' of bank nationalization, such as occurred in that country in the early 1990s when the government took over the banks directly, cleaned up their bad assets, and then spun them off to private interests again in a kind of capitalist form of nationalization.

HASP—Obama's Housing Recovery Proposal

Obama's housing plan has two parts. The first is another $200 billion funding set aside for

Fannie Mae and Freddie Mac. This is just a continuation of prior arrangements under the Bush-Paulson period. The two companies were partially nationalized in August 2008 and provided with $200-$300 billion with which to directly buy home mortgages. By February 2009 they had run out of those funds, and now another $200 billion is allocated as part of the Obama plan. The problem with Fannie/Freddie, however, is that they own only roughly 26% of the $12 trillion residential mortgage market. The major problem with subprime mortgages and foreclosures is occurring totally outside Fannie/Freddie's reach—in the securitized residential mortgage market segment.

Another major problem with this first part of the Obama Housing Plan is that any homeowner that is delinquent, in default, or in foreclosure proceedings is not eligible. Those who need it the most are thus excluded. And if the market value of your home has fallen more than 5% below the mortgage owed, forget it. You don't qualify. In other words, Part 1 is a subsidy to the industry, a gimmick to help lenders refinance safe mortgages and thus generate refinancing income for lenders; it is not a program to help homeowners in distress or to stop housing supply continuing to flood the market and depress housing prices.

As of late February, data show that the US home price index has fallen 27% from its peak in 2006, for the thirtieth consecutive month. The last three months show an accelerating rate of decline. Should prices continue to fall at the rate registered between last November and January 2009, it will mean another 33% fall in median home prices this coming year, according to data from the National Association of Realtors.

A second part of the Obama housing program is to provide a further $75 billion. These funds are committed to subsidizing mortgage lenders to lower their interest rates on new mortgages to 4-4.5% on average from current higher market rates at around 5.5%. Under Plan 2 loan principal may also be lowered to 31% of the homeowners' gross income, but only as a very last resort and for a temporary period of up to five years. And the government will pay (i.e. subsidize) the lenders the difference between the 31% and 38%, or 7% of the loan for that period. Part 2 (unlike Part 1) may apply to homeowners who are delinquent. But it is still largely a voluntary program dependent on the agreement of lenders. And if they are unwilling to modify rates and principals when requested by the homeowner, too bad for the homeowner. While progressive Democrats in Congress are attempting to give bankruptcy judges the power to force lenders to modify loans if they refuse
after requested, that legislation has been vigorously resisted and blocked so far by industry groups like the American Bankers Association.

And who are the financial institutions that will benefit most from Plan 2? The banks. Two thirds of all the home loans in the U.S. are serviced by Citi, JP Morgan Chase, Bank of America and Wells Fargo. Once again, in other words, what we have here is a subsidy to the same institutions set to benefit from the PPIF. It is another version of 'trickle down', in which government-taxpayer money is given to companies to entice them to lower rates which they should be doing on their own in the first place if they want to remain independent.

Like prior Bush initiatives, the approach here is to try to stimulate housing demand and in that way to slow the collapse of housing prices. But the supply of houses coming on to the market is massive, and is swamping any tepid attempts to put a floor under housing prices via a demand side approach. Housing supply has been and will continue to overwhelm housing demand, with the consequent decline of housing prices continuing.

Thus far no credible approach has been offered to check housing supply and stem housing price declines. In the end housing price decline can only be contained by a nationalization of the residential mortgage markets and a fundamental reset of both interest and principle for homeowners in stress—i.e. much as it was done in the 1930s.

Summary and Predictions

The fiscal stimulus side of the Obama program is clearly a case of 'too little too late'. It fails to address the central need of massive job creation. It lacks in both magnitude and composition of its focus. A second stimulus package within a year is inevitable.

The Bank and Finance stability measures of the Obama program are no more likely to succeed. They do not focus on housing asset price collapse directly , but only indirectly via trickle down and subsidization of the mortgage lenders.

Both the original PPIF and the revised PPIP attempt desperately to create a market for bad assets by means of subsidizing both banks and investors at taxpayer expense. The program will require far more than the initially estimated $1 trillion. To the extent the financing comes from the Treasury or Congress, it will mean further taxpayer cost. But should the financing come via the Fed and monetization, the cost will not reflect in the immediate Obama budget but most likely in runaway inflation down the road.

The point is that other less costly approaches exist. To pursue the PPIF-PPIP means to virtually prevent any real stimulus spending package. The bank rescue in its current forms are thus 'crowding out' any chance of real fiscal led recovery. They are draining the financial lifeblood of the taxpayer and the US government itself.

The TALF represents a wild gamble that a revived shadow banking system, and a resurrection of the securitized asset markets will somehow be able to prevent the collapse of the consumer credit (auto, student loan, credit cards) and the commercial property market which will have to refinance more than $170 billion in 2009. However, this is highly unlikely to happen, given the declining condition of hedge funds, private equity, and the rest of the shadow banking community.

The consequence of the all this excess bank rescue spending is a cost to the US taxpayer in the long run of at minimum $4 to $5 trillion. How much directly in the short run via the US budget vs. how much in the long run via 'monetization' through the Fed is unclear at the moment. However, a recent study by University of California economists, Auerbach and Gale, projects annual deficits of $1 trillion or more for each of the next ten years. It is highly doubtful the US economy can sustain that kind of deficit spending for that period of time, without seriously threatening the US Treasury markets and causing an eventual collapse of the US dollar in world markets.

The US and world economy are on the knife-edge of a transition from an Epic Recession to a bona fide Depression. Will there be a depression? The failure of the Obama programs in 2009 to stabilize the economy in this junctural year will raise the possibility of Depression in 2010 to at least a 50-50 possibility. Monetization, 'quantitative easing', by the Fed raises the additional spectre of severe dollar currency instability, global trade instability, and another financial crisis of potentially event greater dimensions down the road.

Any number of several severe events could precipitate a descent into depression. A series of sovereign debt crises in Europe are a real possibility. A likely scenario is the collapse of one or more east European countries that might pull down, for example, Austrian and then Italian banks and spread thereafter to other banking institutions. Another scenario might be the continued escalation of jobless beyond 20 million in the U.S., TALF failure to rescue consumer credit markets, a collapse of the Treasuries markets as Fed 'monetization' continues unabated, and the like. Another precipitating scenario might be the global collapse of bond markets, in particular investment grade bonds, or a severe crisis in the Credit Default Swaps market globally as well. There are of course other potentially serious scenarios that might serve as precipitating events.

Whatever the possible event, one thing is not conjectural at this point. It is that the Obama administration rescue program, as formulated in February 2009, is seriously deficient as a plan to stem the accelerating decline in joblessness and GDP, on the one hand, and as a plan to stabilize the financial system on the other. The failure of the plan in 2009 raises the very real possibility of a further worsening of the current Epic Recession underway in the US and increasingly globally as well. While the economy is not yet in the anteroom of a bona fide depression, it is nonetheless at the front door, which has now been opened.

A new, alternative plan will have to be proposed and implemented before the end of 2009. The 'bank nationalization' debate will re-emerge high on the political agenda once again before year end. The Obama administration will have to get much bolder and aggressive, as the enemies on the right, in corporate boardrooms, among evangelical interests are themselves now gathering their forces. It will be interesting to see whether the Obama team can make the transition from a vision that is much like a Clinton approach in 1993 to one that is more like 1933. However, recent Obama overtures to conciliate and soften its position with the heads of the big banks, hedge funds and the like do not appear as if a more aggressive approach will be undertaken.

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Jack Rasmus's forthcoming book is 'EPIC RECESSION AND GLOBAL FINANCIAL CRISIS'. His works, articles, speeches and interviews are available on his website, HYPERLINK "http://www.kyklosproductions.com" www.kyklosproductions.com.

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