The Bailout of Big American Banks Has Cost Trillions More Than We've Been Told

By Washington's Blog
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Granted, the $700 billion dollar TARP bailout was a massive bait-and-switch. The government said it was doing it to soak up toxic assets, and then switched to saying it was needed to free up lending. It didn't do that either. Indeed, the Fed doesn't want the banks to lend.

True, as I wrote in March 2009:

The bailout money is just going to line the pockets of the wealthy, instead of helping to stabilize the economy or even the companies receiving the bailouts:

Bailout money is being used to subsidize companies run by horrible business men, allowing the bankers to receive fat bonuses, toredecorate their offices, and to buy gold toilets and prostitutes

A lot of the bailout money is going to the failing companies'shareholders

Indeed, a leading progressive economist says that the true purpose of the bank rescue plans is "a massive redistribution of wealth to the bank shareholders and their top executives"

The Treasury Department encouraged banks to use the bailout money to buy their competitors, and pushed through an amendment to the tax laws which rewards mergers in the banking industry (this has caused a lot of companies to bite off more than they can chew, destabilizing the acquiring companies)

And as the New York Times notes, "Tens of billions of [bailout] dollars have merely passed through A.I.G. to its derivatives trading partners".

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In other words, through a little game-playing by the Fed, taxpayer money is going straight into the pockets of investors in AIG's credit default swaps and is not even really stabilizing AIG.

But the TARP bailout is peanuts compared to the numerous other bailouts the government has given to the giant banks.

And I'm not referring to the $23 trillion in bailouts, loans, guarantees and other known shenanigans that the special inspector general for the TARP program mentions. I'm talking about more covert types of bailouts.

Like what?

Guaranteeing a Fat Spread on Interest Rates

Well, as Bloomberg notes:

"The trading profits of the Street is just another way of measuring the subsidy the Fed is giving to the banks," said Christopher Whalen, managing director of Torrance, California-based Institutional Risk Analytics. "It's a transfer from savers to banks."

The trading results, which helped the banks report higher quarterly profit than analysts estimated even as unemployment stagnated at a 27-year high, came with a big assist from the Federal Reserve. The U.S. central bank helped lenders by holding short-term borrowing costs near zero, giving them a chance to profit by carrying even 10-year government notes that yielded an average of 3.70 percent last quarter.

The gap between short-term interest rates, such as what banks may pay to borrow in interbank markets or on savings accounts, and longer-term rates, known as the yield curve, has been at record levels. The difference between yields on 2- and 10-year Treasuries yesterday touched 2.71 percentage points, near the all-time high of 2.94 percentage points set Feb. 18.

Harry Blodget explains:

The latest quarterly reports from the big Wall Street banks revealed a startling fact: None of the big four banks had a single day in the quarter in which they lost money trading.

For the 63 straight trading days in Q1, in other words, Goldman Sachs (GS), JP Morgan (JPM), Bank of America (BAC), and Citigroup (C) made money trading for their own accounts.

Trading, of course, is supposed to be a risky business: You win some, you lose some. That's how traders justify their gargantuan bonuses–their jobs are so risky that they deserve to be paid millions for protecting their firms' precious capital. (Of course, the only thing that happens if traders fail to protect that capital is that taxpayers bail out the bank and the traders are paid huge "retention" bonuses to prevent them from leaving to trade somewhere else, but that's a different story).

But these days, trading isn't risky at all. In fact, it's safer than walking down the street.

Why?

Because the US government is lending money to the big banks at near-zero interest rates. And the banks are then turning around and lending that money back to the US government at 3%-4% interest rates, making 3%+ on the spread. What's more, the banks are leveraging this trade, borrowing at least $10 for every $1 of equity capital they have, to increase the size of their bets. Which means the banks can turn relatively small amounts of equity into huge profits–by borrowing from the taxpayer and then lending back to the taxpayer.

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The government's zero-interest-rate policy, in other words, is the biggest Wall Street subsidy yet. So far, it has done little to increase the supply of credit in the real economy. But it has hosed responsible people who lived within their means and are now earning next-to-nothing on their savings. It has also allowed the big Wall Street banks to print money to offset all the dumb bets that brought the financial system to the brink of collapse two years ago. And it has fattened Wall Street bonus pools to record levels again.

Paul Abrams chimes in:

To get a clear picture of what is going on here, ignore the intermediate steps (borrowing money from the fed, investing in Treasuries), as they are riskless, and it immediately becomes clear that this is merely a direct payment from the Fed to the banking executives…for nothing. No nifty new tech product has been created. No illness has been treated. No teacher has figured out how to get a third-grader to understand fractions. No singer's voice has entertained a packed stadium. No batter has hit a walk-off double. No "risk"has even been "managed", the current mantra for what big banks do that is so goddamned important that it is doing "god's work".

Nor has any credit been extended to allow the real value-producers to meet payroll, to reserve a stadium, to purchase capital equipment, to hire employees. Nothing.

Congress should put an immediate halt to this practice. Banks should have to show that the money they are borrowing from the Fed is to provide credit to businesses, or consumers, or homeowners. Not a penny should be allowed to be used to purchase Treasuries. Otherwise, the Fed window should be slammed shut on their manicured fingers.

And, stiff criminal penalties should be enacted for those banks that mislead the Fed about the destination of the money they are borrowing. Bernie Madoff needs company.

There is another type of guaranteed spread that allows the giant banks to make money hand over fist. Specifically, the Fed pays the big banks interest to borrow money at no interest and then keep money parked at the Fed itself. (The Fed is intentionally doing this for the express purpose of preventing too much money from being lent out to Main Street. That's just dandy.)

The giant banks are receiving many other covert bailouts and subsidies as well.

Too Big As Subsidy

Initially, the fact that the giant banks are "too big to fail" encourages them to take huge, risky gambles that they would not otherwise take. If they win, they make bigbucks. If they lose, they know the government will just bail them out. This is a gambling subsidy.

The very size of the too big to fails also decreases the ability of the smaller banks to compete. And – since the government itself helped make the giants even bigger – that is also a subsidy to the big boys (see this).

The monopoly power given to the big banks (technically an "oligopoly") is a subsidy in other ways as well. For example, Nobel prize winning economist Joseph Stiglitzsaid in September that giants like Goldman are using their size to manipulate the market:

"The main problem that Goldman raises is a question of size: 'too big to fail.' In some markets, they have a significant fraction of trades. Why is that important? They trade both on their proprietary desk and on behalf of customers. When you do that and you have a significant fraction of all trades, you have a lot of information."

Further, he says, "That raises the potential of conflicts of interest, problems of front-running, using that inside information for your proprietary desk. And that's why the Volcker report came out and said that we need to restrict the kinds of activity that these large institutions have. If you're going to trade on behalf of others, if you're going to be a commercial bank, you can't engage in certain kinds of risk-taking behavior."

The giants (especially Goldman Sachs) have also used high-frequency program trading which not only distorted the markets – making up more than 70% of stock trades – but which also let the program trading giants take a sneak peak at what the real (aka "human") traders are buying and selling, and then trade on the insider information. See this, this, this, this and this. (This is frontrunning, which is illegal; but it is a lot bigger than garden variety frontrunning, because the program traders are not only trading based on inside knowledge of what their own clients are doing, they are also trading based on knowledge of what all other traders are doing).

Goldman also admitted that its proprietary trading program can "manipulate the markets in unfair ways". The giant banks have also allegedly used their Counterparty Risk Management Policy Group (CRMPG) to exchange secret information and formulate coordinated mutually beneficial actions, all with the government's blessings.

In addition, the giants receive many billions in subsidies by receiving government guarantees that they are "too big to fail", ensuring that they have to pay lower interest rates to attract depositors.

Derivatives

And the government's failure to rein in derivatives or break up the giant banks also constitute enormous subsidies, as it allows the giants to make huge sums by keeping the true price points of their derivatives secret. See this and this.

Toxic Assets

And the PPIP program – which was supposed to reduce the toxic assets held by banks – actually increased them, and just let the banks make a quick buck.

Mortgages and Housing

PhD economists John Hussman and Dean Baker (and fund manager and financial writer Barry Ritholtz) say that the only reason the government keeps giving billions to Fannie and Freddie is that it is really a huge, ongoing, back-door bailout of the big banks.

Many also accuse Obama's foreclosure relief programs as being backdoor bailouts for the banks. (See this, this and this).

Foreign Bailouts

The big banks – such as JP Morgan – also benefit from foreign bailouts, such as the European bailout, as they are some of the largest creditors of the bailed out countries, and the bailouts allow them to get paid in full, instead of having to write down their foreign losses.

These are just a few of the secret bailouts programs the government is giving to the giant banks. There are many other bailout programs as well. If these bailouts and subsidies are added up, they amount to many tens – or perhaps even hundreds – of trillions of dollars.

And then there is the cost of debasing the currency in order to print money to fund these bailouts. The cost to the American citizen in less valuable dollars will be truly staggering.

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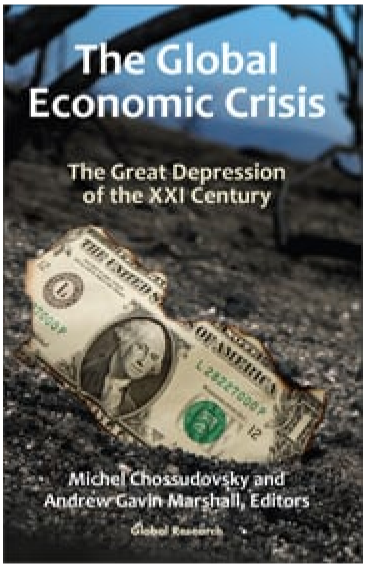

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