Wall Street celebrates government windfall for banks and big investors

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Wall Street erupted in a demonstration of euphoria and greed Monday as the Obama administration announced a plan to offload bankers' bad debts that amounts to an unprecedented looting of taxpayer funds to benefit the financial elite.

All of the major stock indexes soared as Treasury Secretary Timothy Geithner laid out details of the administration's so-called Public-Private Investment Program—a euphemism for a scheme to bankroll private investment firms and guarantee them huge profits in return for buying failed home loans and securities from the banks at vastly inflated prices.

The masters of Wall Street, who have been driving up share prices in recent days—especially bank stocks—in anticipation of the roll-out of the program, were delighted to find that it not only met, but exceeded their expectations.

Hedge funds and private equity firms that participate in the scheme will put up as little as 5 percent of the capital to buy between $500 billion and $1 trillion of the banks' junk assets, with the government providing the rest in the form of $75-$100 billion in Treasury funds and low-cost loans from the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC). The loans will be guaranteed by the government, which will assume the overwhelming bulk of any losses.

Even though the bulk of the capital and financing will come from the government, the public-private investment funds set up under the scheme will be run by private investment firms, which will receive lucrative fees for dividing up the booty.

The banks cheered the deal because it will allow them, at their own discretion, to palm off their bad debts at prices many multiples of what they could currently fetch on the market. Since the government will bankroll the big investors and assume virtually all of the risk, the investors will be willing to pay inflated prices for the illiquid loans and securities in government-supervised auctions. They calculate that they can hold the assets until the housing market recovers and then sell them back to the financial markets at a return of 20 percent or more.

For their part, the banks will be able, at little cost, to cleanse their balance sheets of what is routinely referred to as "toxic waste," laying the basis for a big rise in their stock.

The entire scheme is voluntary. No one on Wall Street is required to do anything—unless he judges there is a substantial profit to be made. There is no requirement that the banks increase their lending. They can choose to continue to hoard their government windfalls—as they have done thus far with the billions they've received in cash injections and government loans—in order to pressure the state for even more favorable terms.

Stocks opened sharply higher after Geithner's presentation of the plan to reporters Monday morning. They continued to rise throughout the day. The Dow Jones Industrial Average closed with a gain of 497 points, or 6.8 percent. It was the Dow's biggest one-day rise since October 28, bringing it 18.8 percent higher than its low earlier this month. The other major indexes—the Standard & Poor's 500 and the Nasdaq—registered similar gains.

It was, above all, a banner day for bank stocks. Citigroup finished up 19 percent, Bank of America rose 26 percent, JPMorgan Chase closed 25 percent higher and Wells Fargo ended with a gain of 24 percent.

There was a political as well as an economic component to the jubilation on Wall Street. The plan and the related statements of top administration officials, beginning with Obama, were rightly taken to demonstrate that the Obama administration is nothing more than a direct instrument of the most powerful sections of the financial aristocracy.

Top administration economic officials and Obama himself spent the weekend reassuring Wall Street, which responded with fury to a bill passed by the House of Representatives taxing the bonuses of wealthy executives and traders at AIG and other bailed-out firms, that they did not support the measure and would impose no executive pay limits on firms that participated in the new bank bailout measure.

With Wall Street executives threatening to boycott the program unless they were given ironclad assurances that their fortunes would not be touched and there would be no "change in the rules" down the road, Geithner gave an interview that was published by the Wall Street Journal Monday morning pleading for hedge funds and banks to participate. "The Obama administration believes those provisions shouldn't apply to such broad programs [as the Public-Private Investment Plan] and an exception was made last month for participants in the Federal Reserve's consumer-lending facility," the newspaper reported.

The same issue carried a column by Geithner entitled "My Plan for Bad Bank Assets" which declared that "we need to be very careful not to discourage those investments the economy needs to recover from recession." It went on to equate protecting the million-dollar bonuses awarded by firms that have bilked the public for billions of dollars with defending "the rule of law." Geithner solemnly wrote that "when our government gives its word" to "responsible entrepreneurs and investors… we mean it."

In his press briefing Monday morning, he rejected any suggestion that the government might temporarily nationalize failing banks and declared, "We're going to do what's necessary to protect the system."

Obama, in remarks to the press on the toxic asset plan following a meeting with his top economic advisers, affirmed that it "will involve market participants who have every interest in making a profit."

In fact, the plan was drawn up in the closest consultation with the billionaire bankers and hedge fund managers who stand to profit from it. The Financial Times reported Monday:

"People close to the situation said the plan was the result of detailed talks between Treasury, banks, private equity groups and other investors over the past few weeks. Senior private equity executives said the key terms of the initiative unveiled on Monday went beyond their own wish-lists.

"Some investors had asked Treasury to provide debt equal to around three to four times the value of the equity to be injected in the public-private partnerships, but the authorities decided to grant leverage of up to six times for the purchase of toxic loans, making it even more attractive for private equity groups to participate in the plan…

"'As it stands, there is very limited downside for us,' a senior Wall Street banker said. 'If we like the price offered, we will sell the assets and record an accounting gain and if we don't, we will stay as we are.'"

Among the big Wall Street investors who praised the scheme and announced their intention to get in on the action was Bill Gross, the founder and head of Pacific Investment Management Co. (PIMCO), the world's biggest bond fund. Gross, along with billionaire investor Warren Buffett and Goldman Sachs CEO Lloyd Blankfein, first broached the idea of creating public-private investment funds to buy toxic bank assets with Treasury officials last fall.

The noted economist Jeffrey Sachs provided an accurate characterization of the plan in a commentary published Monday by the Huffington Post.

He wrote: "Geithner and Summers [Lawrence Summers, director of the White House's National Economic Council] have now announced their plan to raid the Federal Deposit Insurance Corporation (FDIC) and Federal Reserve (Fed) to subsidize investors to buy toxic assets from the banks at inflated prices. If carried out, the result will be a massive transfer of wealth—of perhaps hundreds of billions of dollars—to bank shareholders from the taxpayers (who will absorb losses at the FDIC and Fed)…

"The investment funds will have the following balance sheet. For every $1 of toxic assets that they buy from the banks, the FDIC will lend up to 85.7 cents (six-sevenths of $1), and the Treasury and private investors will each put in 7.15 cents in equity to cover the remaining balance. The Federal Deposit Insurance Corporation loans will be non-recourse, meaning that if the toxic assets purchased by private investors fall in value below the amount of the FDIC loans, the investment funds will default on the loans and the FDIC will end up holding the toxic assets…

"The FDIC is giving a 'heads you win, tails the taxpayer loses' offer to the private investors."

Princeton University economist and New York Times columnist Paul Krugman offered a similar assessment, writing, "But the Geithner scheme would offer a one-way bet: if asset values go up, the investors profit, but if they go down, the investors can walk away from their debt. This isn't really about letting markets work. It's just an indirect, disguised way to subsidize purchases of bad assets."

Mournfully, he noted, "It's as if the president were determined to confirm the growing perception that he and his economic team are out of touch, that their economic vision is clouded by excessively close ties to Wall Street."

It is not, however, a matter of Obama's "clouded vision," but rather an administration that embodies the reality of class relations in America and the dictatorship of finance capital which is exercised through a political system dominated by two parties of the capitalist ruling elite. The wholesale theft of the social wealth embodied in the latest bailout scheme is a continuation of a policy that has, from day one, been driven by horror not at the impoverishment of tens of millions of workers, but rather the prospect that the crisis of their own making could cut into the vast wealth of the financial oligarchs.

On Monday, Wall Street celebrated the fact that it has in Washington a bunch of lackeys who can be counted on to do its bidding.

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