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Financial Crisis: Toxic Plans for Toxic Assets

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Exit Paulson, enter Geithner with the latest "no banker left behind plan" – aka whatever Wall Street wants, Wall Street gets. Yet, the reception was underwhelming. The Dow plummeted 382 points while investors took shelter in bonds and gold. AP reported that "the new bank rescue plan landed with a thud on Wall Street" as investors worried that no end to the crisis is in sight. Editorial and op-ed commentaries were near unanimously negative and some especially critical.

At a February 9 congressional briefing, lawmakers greeted Geithner with laughter and sarcasm, but most of it is just politics. Bailout opponent Brad Sherman (D, California) asked for details and a dollar amount, but instead got generalities about what he announced the next day – a plan to:

— "clean up and strengthen the nation's banks;" in other words, spend hundreds of billions more to recapitalize insolvent ones;

— create a Public – Private Investment Fund to shift toxic assets from them to the public;

— expand the Fed's Term Asset-Backed Securities Loan Facility (TALF) to provide funding for investors to buy toxic assets; partial government guarantees would be offered as incentive; and

— use "the full resources of the government to bring down mortgage payments (and) reduce mortgage interest rates;" already tried are foreclosure moratoriums, payment reductions, re-amortizations of delinquent balances, interest rate cuts, and more; yet home prices keep falling; a glut of unsold homes remains; foreclosures mount at a ferocious pace; the Foreclosure Data Bank cites "over 1 million bank foreclosures for sale;" and borrowers with modified loans are re-defaulting anyway.

The Office of the Comptroller of the Currency (that charters, regulates, and supervises national banks) reported that 36% of first quarter 2008 modified loans were delinquent after three months and 58% after eight months. The main problems are over-indebtedness and huge numbers of continuing job losses.

Geithner omitted these facts and that each of his elements conflicts with the others. Most important, instead of closing or nationalizing zombie banks, punishing their top executives for decades of criminal fraud and excess, and wrecking the global economy, Geithner, like Paulson, will reward them as The New York Times reported.

On February 10, it explained that he'll "flood the financial system with as much as $2.5 trillion" on top of $9 trillion previously doled out, and this is just "Stage One of a two-stage plan," according to economist Michael Hudson. He asked: "recovery for whom (and what do) they want to recover?" For Wall Street, of course, in a new "Bubble economy" of the kind Alan Greenspan engineered: "wealth in the form of indebtedness of the 'real' economy at large to the banking system, and unprecedented capital gains to be made (from) a wave of asset-price inflation."

The problem, according to Hudson, is it can't be done given "today's debt levels, widespread negative equity, and still-high level of real estate, stock and bond prices. No amount of new (bank) credit or capital will induce (them to loan more) to real estate that already is over-mortgaged, or to individuals and corporations already over-indebted" or on the edge like the auto giants, auto suppliers, homebuilders, others, and who knows who next will join them.

Geithner got hammered on all fronts, including by former hedge fund manager Andy Kessler in a February 10 Wall Street Journal op-ed saying:

"The Treasury secretary seems stuck on keeping the banks we have in place. But we don't need zombie banks overstuffed with nonperforming loans – ask the Japanese. Mr. Geithner wants to 'stress test' banks to see which are worth saving. The market already has" with Citigroup, Bank of America and others now a mere fraction of their former worth, and Geithner's idea is to "throw good money after bad to a banking system struggling under the weight of its own mistakes."

"What we need are healthy banks with clean balance sheets and enlightened risk assessment to provide consumer and business loans that will generate returns to shareholders." Let them sell their own toxic debt. They won't because they "don't like the price." As for TARP, it failed and so will TARP 2.0 or what's now called a Financial Stability Plan. The idea is to get "private capital to buy bad loans and derivatives," but banks won't price them low enough to sell. Moreover, who'll buy risky assets unless they're practically given away or Washington guarantees them.

Kessler wants the banks nationalized but only short-term. Others agree saying no quick fixes are possible, and Financial Times writer Martin Wolf asked whether Obama's presidency already failed in headlining his February 10 column: "Why Obama's new Tarp plan will fail to rescue the banks."

It looks like "yet another child of the" previous year and a half's interventions: "optimistic and indecisive" at a time "focus and ferocity" are needed. Instead of crafting a surer solution, it timidly chose "three arbitrary, self-imposed constraints: no nationalisation; no losses for bondholders; and no more money from Congress."

Better advice is what Washington gave the Japanese in the 1990s but won't follow itself: "admit reality, restructure banks, (create good ones) and above all, slay zombie institutions at once." Instead, dead banks keep walking away with trillions more good money after bad.

It's why banking analyst Meredith Whitney told Bloomberg (on February 4) that "Investors should not even consider owning banks at this point on an equity basis." Looking forward, she also doubts that Citigroup will exist in its current form, large numbers of Wall Street layoffs will continue, and eventually "we'll go back to an older and smaller bank system, where local banks lend off what they have in deposits."

In October 2007, Whitney was one of the first to spot trouble when she predicted that

Citigroup would cut its dividend in the face of a weak balance sheet. She followed by forecasting losses and write-downs at Bank of America, Lehman Bros., and UBS as well as insights on bond insurer implosions that threatened banks' bottom lines. More still about damaged assets at Merrill Lynch.

She advised investors to bail out of bank stocks and saw the economy heading into an "early 1980s-style" recession that would devastate 10% of the population that was overextended by the housing boom. She said: "It feels like I'm at the epicenter of the biggest financial crisis in history," yet she didn't realize how accurate that was at the time.

She criticized the incestuous relationship between Wall Street and the credit-rating agencies that, in her judgment, would impede the banks' ability to recover. They hated her, but one top Citigroup executive said: "You've got to give it to her – she figured it out," well enough that today her comments move markets.

Investor Jim Rogers never holds back, and, on February 11, was true to form on Bloomberg: Interviewed on Geithner's plan he said:

"Mr. Geithner has been bombing for 15 years. (He) caused the problem. He was head of the New York Fed that was supposed to be supervising banks. (Instead), all last year he came up with TARP. He came up with all these absurd bailouts. Geithner's has never known what he's doing. He doesn't know what he's doing now, and pretty soon everyone will know it, including Mr. Obama."

Asked how to fix the problem, he referenced Washington's advice to Japan in the 1990s. "You let (bad banks) go bankrupt. You clean out the system. You wipe out insolvent ones and let (good banks) take over. America is making the same mistake (as Japan), and the politicians are making it worse. You want to know why they're making it worse? They want to support their friends on Wall Street."

"The idea of the government buying up bad assets is not going to work." Either the price will be too high (at taxpayer expense) or it will be too low….it's not going to work. It's never worked….Pouring in new money will only weaken the whole system. Go back in history and see what worked. Countries that took their pain (solved their crisis). It was horrible going through it, but they came out of it and became rapidly growing. Countries that did it our way never came out of it until a long, long time later, if ever."

"What Geithner should have said was we have a horrible problem of too much borrowing, too much debt, and too much consumption. You know what we are going to do – we're going to borrow more, go deeper in debt, and consume more….These guys don't know what they're doing (and it's why) I'm shorting" the market.

Is It Time to Nationalize Insolvent Banks?

George Soros framed it this way:

"The hard choice facing the Obama administration is between partially nationalizing the banks, or leaving them in private hands but nationalizing their toxic assets."

For Nouriel Roubini in his February 10 commentary, the choice is clear – the former, not the latter option that will be a "royal (taxpayer) rip-off" if assets are bought at above market valuations.

He sees losses so large that the US banking system "is effectively insolvent in the aggregate." So are most UK banks and many other continental European ones. He lists four Obama options under consideration:

(1) "recapitalization together with" some kind of government "bad bank" purchase of toxic assets;

(2) "recapitalization together with government guarantees – after a first loss by the banks – of the toxic assets;"

(3) "private purchase of toxic assets with a government guarantee and/or....public capital to set up a public-private bad bank where private investors participate" in buying bad assets; or

(4) "outright government takeover" through nationalizations or "receivership" to be cleaned up, then sold back to private investors.

The first three are deeply flawed. A bad bank may overpay at higher cost to taxpayers. If it buys at mark-to-market prices, "many banks (may go) bust." Even offering guarantees cause "massive valuation problems (with) very expensive risks for taxpayers." Under a bad bank, "the government has the additional problem of having to manage" these assets, something it has little expertise doing.

Geithner's proposal for removing bad assets is "very cumbersome," problematic, and foggy on details. Its main problem is it may end up being "a royal rip-off of the taxpayer if the guarantee is excessive given the true value of the underlying assets." On the other hand, low valuations will expose bank insolvencies and show that government takeovers are essential.

All proposed plans so far "may be a big fudge that either (don't) work or work only if the government bails out shareholders and unsecured (bank) creditors."

Roubini calls nationalization the best option to let shareholders take the pain, not the public. It also "resolves the too-big-to-fail problem (because it's now) become an even bigger-to-fail" (one) as the approach (of letting) weak banks take over weaker ones" has failed.

Sweden in the 1990s had the right approach. Japan had a lost decade with the wrong one and is still mired in trouble. "The US, UK and other (troubled) economies risk near depression and stag-deflation....if they fail to appropriately tackle this most severe crisis."

Plans so far adopted have failed. Wasting more months on more of the same may turn a "U-shaped recession into an L-shaped near depression" with governments forced to nationalize anyway. Roubini proposes Plan N for "nationalization of insolvent banks" here and in other troubled economies.

In a February 15 Washington Post op-ed, Roubini and Matthew Richardson headlined: "Nationalize the Banks! We're all Swedes Now." The US banking system is so close to the edge that "unless we want to become like Japan in the 1990s — or the United States in the 1930s — the only way to save it is to nationalize it."

The time for dithering is past. "We have used all our bullets, and the boogeyman is still coming. Let’s pull out the bazooka and be done with it.”

Roubini and Richardson are “free-market economists” and New York University Stern School of Business professors.

Michael Hudson’s Way “to Save the Economy from Wall Street”

In his view: “The only real solution to today’s debt overhang is a debt writedown,” and let debtors (the banks and others) take the pain, not the public. “Until this occurs, debt service will crowd out spending on goods and services and there will be no recovery. Debt deflation will drag the economy down while assets are transferred further into the hands of the wealthiest 10 percent of the population (in the financial sector)” while the rest of us get poorer.

Wall Street wants another way, and that’s the problem. It wants costs socialized and profits privatized. It believes “free markets are ‘free’ of public regulation against predatory lending; ‘free’ of taxing the wealthy (and) shift(ing) the burden onto labor; ‘free’ for the financial sector to (plunder) the ‘real’ economy like parasitic ivy around a tree to extract the surplus.” This makes a travesty of freedom, but they get away with it because presidents like Obama let them, and, according to one observer, trillion dollar giveaways are like buses. They’ll be another one along shortly.

Paul Krugman on Obama’s Stimulus Plan

On February 12, Krugman’s New York Times article headlined: “Failure to Rise.”

“Break out the Champagne,” he wrote….”Or maybe not. These aren’t normal times (so) Obama’s victory feels more than a bit like defeat. The stimulus bill looks helpful but inadequate, especially when combined with a disappointing plan for rescuing the banks.” Disappointing? Corrupted and awful more accurately describes it.

As for stimulus, Republicans backed the idea that Bush’s tax cuts for the rich deserves more of them while John McCain called aiding troubled households “generational theft.”

Obama got what he asked for, but “almost certainly didn’t ask for enough.” While $800 billion sounds impressive, it doesn’t bridge the $2.9 trillion gap between the economy’s ability to produce over the next three years and what, in fact, it will, according to the Congressional Budget Office.

It’s also too long on tax cuts and not enough for millions of troubled households. Overall, “the Obama administration’s response….is all too reminiscent of Japan in the 1990s: (hoping for) a fiscal expansion large enough to avert the worst, but not enough to kick-start recovery; (it) supports the banking system, but (is) reluctant to force banks to take their losses.”

“….I’ve got a sick feeling in the pit of my stomach….that America isn’t rising to (its) greatest economic challenge in 70 years….they seem alarmingly willing to settle for half (and failed) measures (that expose) the grotesque failure of their doctrine in practice.” So far the “verdict” on Obama is “no, we can’t.”

Today’s Global “Financial Coup d’Etat” Legacy

Catherine Austin Fitts was a high-level business and government insider and now is Solari.com's editor. On February 2, her Financial Coup d'Etat article discussed a "Washington – Wall Street partnership" that for years:

— through fraud, engineered a housing and debt bubble;

— illegally offshored vast sums of capital globally; in Russia, for example, where millions of people discovered their bank accounts and pension funds were gone – "eradicated by a falling currency or stolen by mobsters who laundered money back into big New York Fed member banks for reinvestment to fuel the debt bubble;"

— turned privatization schemes into "piracy," or what she calls "mov(ing) government assets to private investors at below-market prices and then shift(ing) private liabilities back to government at no cost to the private liability holder."

This was in the 1990s. Eight years under George Bush accelerated these practices and created today's global economic crisis, the result of a "Washington – Wall Street game." People everywhere are "up against the same financial pirates and (economic warfare) model" as those in America and the West.

Year after year, a bankster – politician conspiracy continues the global heist – sucking trillions of capital "out of country after country," including in America from Americans. Fitts posed a question she raised in 2001: once the bubble economy imploded, is "the time coming when we (like emerging economies) would be de-modernized?" More than ever, "this is the question" we must ask, and how that prospect affects us.

Stimulus 101 – The Devil Is in the Details and Follow-Through

Hudson again: Trillions for banksters, crumbs for the public. But fixing today's economy requires change. "Today's economic shrinkage cannot be reversed without a recovery in consumer demand." Not a small or temporary one, a real sustained one. "The economy has lost the 'virtual wealth' in higher-priced homes and (a healthy) stock market, and must rely on after-tax earnings (alone). But I see little concern for wage earners in the Treasury plan," and not enough in the stimulus. "Without debt relief (and ending job losses), consumer spending and business investment will not recover."

Geithner's plan doesn't address this. "It seeks to recover the debt-bubble economy, not the real (one) of production and consumption." It's the same failed approach as under Bush. Why not? As New York Fed president, Geithner and Paulson engineered it along with Fed chairman Bernanke.

As for "stimulus," the House and Senate (on February 13) passed the American Recovery and Reinvestment Act (ARRA) of 2009. It contains 1041 pages, and as Bloomberg reported, full details "were still emerging as the plan headed for congressional passage." Others in Congress complained that it was impossible to read ahead of the rushed through vote.

From what's known, here's a breakdown of most of the approved $787 billion:

Overall

— $287 billion in tax cuts; $310 billion in discretionary spending, including infrastructure, energy and healthcare systems; and $190 billion for benefits, including unemployment and

Medicaid.

For the Poor and Unemployed

— $40.5 billion for 20 extra weeks of unemployment benefits through December 31 plus another 13 weeks for workers in 30 “high unemployment” states; also a temporary extra $25 weekly benefit, and the first $2400 in benefits are exempt from federal income tax in 2009;

— $20 billion for food stamps;

— $3 billion in temporary welfare and other miscellaneous benefits.

Comment: these are meagre amounts for millions of beleaguered households, including one worker every five seconds losing his or her job; many more forced to part-time from full-time ones; pensions and benefits being lost; and tens of millions in the country overall under growing duress.

Direct Cash Payments

–$14 billion for one-time $250 payments to Social Security recipients, poor people on Supplemental Security Income, and veterans on disability and pensions.

Comment: the amount is so small, it hardly matters.

Infrastructure

— $46 billion for transportation projects, including $27 billion for highways and bridge construction;

— $8.4 billion for mass transit;

— $8 billion for high-speed railways; $1.3 billion for Amtrak;

— $4.6 billion for the Army Corps of Engineers;

— $4 billion for public housing;

— $6.4 billion for clean and drinking water projects;

— $7 billion for broadband Internet service to underserved areas.

Comment: most allocations are small; will take time to kick in; and will mostly enrich developers, construction firms, and the FIRE sector (finance, insurance, and real estate).

Health Care

— $24.7 billion for a 65% subsidy for health insurance premiums for up to nine months for the newly unemployed under the (1985-enacted) COBRA program; COBRA lets these workers keep their health insurance for a limited time; those eligible are individuals earning $125,000 or less and couples with incomes of $250,000 or less;

— $87 billion to states for Medicaid;

— $19 billion to modernize health information technology systems – this is a plan to create a health history database for everyone in the country; let private produce business produce and control it, and share or sell the information to all takers; in other words, our personal health history will be privatized for profit;

— $10 billion for health research and construction of National Institutes of Health facilities;

— $8 billion to states to defray budget shortfalls.

Comment: some of this will help, but it's not enough; no plan is envisioned for even partial national health care at a time nearly 50 million Americans are uninsured and millions more will be in coming years; as for the states and cities, combined they need tens of billions to close their budget gaps.

Energy

— $50 billion for various programs; some for efficiency, weatherizing low-income homes, and likely small amounts for renewable energy – too small to matter;

— $6.4 billion for nuclear weapons site clean up; the problem is so great, tens of billions are needed;

— $11 billion for a so-called "smart electricity grid" to reduce waste;

— $13.9 billion for subsidized renewable energy project loans;

— $6.3 billion for state efficient and clean energy;

— $4.5 billion to make federal buildings more energy efficient.

Comment: nearly all of this is for business.

Education

— $47 billion for states to relieve budget shortfalls and other purposes;

— $26 billion for special education and No Child Left Behind privatization and testing programs in K-12;

— $15.6 billion for Pell Grant increases by $500 – $5350 in 2009 and $5500 in 2010;

— $2 billion for Head Start.

Comment: like the Bush administration, Obama and his Education Secretary, Arne Duncan, are committed to destroying public education nationally and turning it over to business for profit.

Homeland Security

— $2.8 billion for DHS programs, including $1 billion for airport screening equipment.

Comment: this is more funding to militarize the country.

Law Enforcement

— $4 billion to states and local law enforcement for officers and equipment.

Comment: still more funding for militarization.

Taxes

— a new tax credit: $115 billion for a $400 per worker, $800 per couple tax credit in 2009 and 2010;

— starting in June 2009, most workers will have about $15 less per bi-weekly pay period withheld from paychecks over a one-year period;

— millions of Americans who earn too little to pay federal income tax can file returns in 2010 and receive credits;

— individuals earning over $75,000 and couples exceeding $150,000 will receive reduced amounts; individuals earning over $100,000 and couples $200,000 get nothing;

— $70 billion in 2009 for alternative minimum tax (AMT) relief for about 24 million taxpayers; an average family of four affected will save $2300; this is substantial since families earning as little as $45,000 otherwise would be taxed;

— $13.9 billion for a $2500 expanded tax credit (above the current $1800) for college tuition and related expenses for 2009 and 2010; the credit applies for individuals earning no more than $80,000 and couples a maximum $160,000; this helps but barely relieves the burgeoning tuition burden that makes college unaffordable for millions without considerable scholarship aid plus the ability to get loans for the residual;

— $5 billion in 2009 for faster business depreciation on equipment, including computers;

— $6.6 billion for a temporary $8000 first-time home-buyer credit for purchases after January 1 and before December 1, 2009; removed is the current requirement for credits to be repaid if buyers stay in their homes for less than three years; those eligible are individuals earning $75,000 or less and couples earning $150,000 or less;

— $2.5 billion to make sales and excise taxes paid on new car, recreational vehicle or motorcycle purchases tax deductible; excluded are individuals earning $125,000 or more and couples earning $250,000 or more;

— $14.8 billion for a temporary child tax credit increase by lowering the income threshold to $3000 in 2009 and 2010;

— $4.6 billion for a temporary earned income tax credit to 45% from 40% for qualifying families with three or more children; it also includes marriage penalty relief for couples who qualify;

— companies and buyout firms that restructure debt without bankruptcy also get tax help; and

— a late addition was a $3.2 billion tax benefit for General Motors and a $19 billion tax refund commitment to businesses for later this year;

Comment: some provisions for the public are helpful but fall way short of aiding beleaguered homeowners and restoring jobs and income, without which economic recovery won't happen.

Overall, "stimulus" provides some household help given the degree of public anger that could boil over without it. The amounts, however, are small, inadequate, and, at best, for temporary, not longer term, relief, and even then, way too little for people most in need.

Critics call it a spending, not a stimulus, bill. Others fear unmanageable deficits and the willingness of foreign capital to keep financing them. Mostly there's concern for what economists like Michael Hudson, Nouriel Roubini and others explain. Nationalizing zombie banks and writing down their debt is the only way back to economic health, but administration plans aren't proposing it.

ARRA Caps on Executive Pay?

A late ARRA provision caps top executives' pay at $500,000 for firms getting government "exceptional assistance." It also restricts bonuses and other incentive compensation (but not retroactively), including severance packages, for the five most senior officers and 20 highest-paid executives. Wiggle room divides beneficiaries into two categories – those getting "exceptional assistance" and others aided through programs like the original TARP with $350 remaining in to be dispensed.

Restrictions have been imposed before and failed as little enforcement is applied, and companies can manipulate rules to avoid them. It's likely they'll do it again, and who'll be watching to stop them.

On February 15, Bloomberg acknowledged it in an article headlined: "Obama to Work on Executive-Pay Limits After Industry Complaints." In other words, legislate tough rules, then arrange "technical" ways around them even though presidential spokeswoman Jen Psaki said "The president shares a deep concern about excessive executive compensation."

Apparently not enough and a greater concern for Wall Street, and why not. Along with corporate lobbyists, major law firms, and the health industry, the entire FIRE sector comprised his largest campaign contributors.

Help for Beleaguered Homeowners?

On February 13, AP reported that Obama will outline a foreclosure prevention plan in a February 18 speech. Efforts by the Bush administration failed, so critics wonder whether new efforts will fare no better than old ones. Maybe they'll be old ones repackaged.

Perhaps because they'll work about the same way with lower rates, reduced monthly payments, extended loan terms, and adding unpaid balances to principal. It's called negative amortization to restructure lower payments than the full amount due. Interest accrues and principal increases. A day of reckoning is delayed for when home prices are lower but even less affordable because mortgage balances are higher than property values. In other words, the solution is worse than the problem. Owners get deeper in debt, become levered renters, and later on end up defaulting anyway.

Further, Bank of America's mortgage group tracks most at-risk borrowers. Those most likely to default have Jumbo and Options ARMS. Jumbos are mostly debt and little equity. Options are even more aggressive as lenders distinguish between the offered and payment rates that can be substantial. They also can be interest-only arrangements causing negative amortization, and rates can be adjusted from day one. Home buyers are enticed by teaser rates as low as 1%. But payment amounts are much higher and can change at any time.

Preventing these types of risky mortgage foreclosures will take far more than the suggested $50 billion total Obama may announce, perhaps eight or ten times that amount, structured to advantage homeowners, not lenders. Even then, quick fixes won't solve today's problems – just time, patience, good policy, and government working for people, not predators, something Washington never does.

A Final Comment

Examine Obama's economic team. Poor policy produces failed results no different than under George Bush. Neither Bernanke or Greespan saw bubbles, so it's no surprise that in late 2006 Mr. B. said "US housing prices merely reflect a strong US economy." Today he risks serious inflation by flooding the market with liquidity and worrying later how he'll sop it up.

Debt defines today's crisis, yet under Bush, Geithner, as New York Fed president, helped fuel it and believes more debt, over-consumption, and unaffordable new borrowing will return the economy to sustainable growth which, of course, it can't.

Larry Summers completes the economic troika as head of the National Economic Council (NEC). As Clinton's Treasury Secretary, he engineered Gramm-Leach-Bliley in November 1999. It let commercial and investment banks and insurance companies combine and eased the way for rampant speculation, fraud, abuse, and multiple bubbles that created today's crisis.

Paul Volker plays a role as well as special Economic Recovery Advisory Board head, but look at his resume. As Fed chairman in 1979 and the early 1980s, he engineered a deep recession and set in motion a path to neoliberalism. He helped destroy family farms, crush labor, reduce wages, lower living standards, send unemployment soaring, rev up de-industrialization, and supercharge the early years of financialization and casino capitalism under Ronald Reagan.

With this kind of "dream team," Obama may match or exceed "the most incompetent eight years of government in modern times, and (be) a contender" for all time, according to money manager and market strategist Jeremy Grantham. If so, the worst of today's crisis lies ahead. Massive future plunder is coming to make working Americans no better off than millions of global wage slaves, that is if they have any decent employment at all.

Meanwhile in Rome, G 7 finance ministers and central bankers promised to "stabili(ze) the global economy (and take) exceptional measures....using the full range of policy tools to support growth and employment and strengthen the financial sector." Surely as well as they've done it up to now.

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