The US Trasury Public-Private Banker's Bonanza

Geithner Update: Grab Yer Ankles and Say "Uncle Sam"

By Mike Whitney
Global Research, March 25, 2009
25 March 2009

Region: USA
Theme: Global Economy

Timothy Geithner refuses to take underwater banks into receivership and resolve them, but has no problem turning the FDIC into a hedge fund. That's right; under Geithner's "Public Private Investment Partnership" (PPIP) FDIC chief Sheila Bair will assume the mantle of Bernie Madoff and oversee the establishment of Hedge Fund USA, a behemoth government-owned operation that will enlist the talents of five or six Wall Street managers to conduct auctions for toxic home loans and other repellent securities. The new program, which will provide lavish subsidies to investors, marks the first time that a standing government has transformed itself into a financial institution for the sake of its primary constituents, the banks. The PPIP creates a state-funded clearinghouse for overpriced junk derivatives and then passes the windfall on to over-leveraged Wall Street speculators. Go figure?

Here's what everyone needs to know: The US government (you) will provide up to 94 percent of the financing (low interest, of course) for dodgy mortgage-backed assets that no one in their right mind would ever buy so that wealthy and politically-connected banksters can scrub up to $1 trillion of red ink from their balance sheets. Ugh!

The so-called "private partners" in this confidence scam will get non recourse loans, which means that if the plan backfires and they lose their skimpy six percent investment, they can call it quits and leave the taxpayer holding the bag. ($1 trillion in potential losses!) Here's how Paul Krugman sums it up:
"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."

"Markets"? Who said anything about markets? This is corporate welfare, pure and simple.

Also, the partnerships will be conducted through off-balance sheets operations (Enron-type structured investment vehicles or SIVs), so the parent company (our new business partners) can avoid liability when they dump all types of ineligible, unmarketable, toxic garbage into the program, which they will, since the average banker has moral scruples of Hannibal Lector.

The opportunities for fraud in Geithner's public-private Banker's Bonanza are truly breathtaking. All the bank has to do is shovel its mountainous pile of B-grade dog dung into its newly minted SIV and then hide behind its government issue "no risk" loan and claim ignorance when the FDIC tries to get its money back.

"I'm so sorry. How did that 2006 vintage subprime CDO made up of liar's loans from unemployed Pizza Hut workers get mixed up in there? My bad."
Geithner's plan assumes that the market has made a terrible mistake misjudging the true value of these unloved assets. He thinks that if the government just adds a trillion or so of liquidity and its explicit Seal of Approval, the securitization markets will miraculously spring to life, the credit logjam will loosen, and Wall Street will return to the high-flying Maestro days of easy money and burgeoning profits. Geithner refuses to accept that the market is right; that assets which originated through lax lending standards, faulty ratings and hyperbolic market conditions are actually worth only pennies on the dollar. Thus, the whole concept of the PPIP — which is to keep asset prices artificially high through government injections of leverage — is wrong and only puts off the inevitable writing-down of bad debt until a later date. Geithner's job is to fix a system that is on its last legs and needs emergency triage. Instead, he is merely adding a few more gusts of helium to a burst bubble.

In Geithner's defense, we should try to understand the challenge he is facing. It's not easy pulling the wool over people's eyes, especially when they've been repeatedly fleeced. The Treasury Secretary's main job is "to keep the big banks in private hands" and to remove over a trillion dollars of toxic mortgage-backed assets that are worth only a fraction of their original value. According to economist Dean Baker, these junk assets are worth roughly 30 cents on the dollar, although the banks have them listed on their books at 60 cents on the dollar. If the banks are not able get full price, then many of them will be forced into bankruptcy. Geithner's job is to make sure that doesn't happen, which is why he has created the "public-private partnership" smokescreen to conceal the fact that the government is intentionally overpaying for significantly downgraded sludge. Here's how economist James Galbraith puts it:

"The bad assets are bad because they are worth less than the banks say they are. House prices have dropped by nearly 30% nationwide. That has created something in the neighborhood of $5+ trillion of losses in residential real estate alone (off a peak market value of housing about $20+ trillion). The banks don't want to take their share of those losses because doing so will wipe them out. So they, and Geithner, are doing everything they can to pawn the losses off on the taxpayer."

Galbraith explains why Geithner has avoided "price discovery" at all cost. Consider this grim factoid for a minute: We are now 19 months into the biggest economic catastrophe since the Great Depression and STILL the public has no fixed idea of what these rotten assets are really worth. The business media, the government and big finance have engineered the biggest cover-up in history just to protect the interests of crooked banksters. Is that how a free market is supposed to work?

The question that should be on top of everyone's list is this: Why would Geithner create a program that rewards bankers and hedge funds at the expense of the public? Or to be more specific: What manner of man would conjure up a transaction where taxpayers put up 94 percent of the investment but only stand to get 50 percent of the profits?

Who is Geithner working for anyway?

There's no getting around the fact that Geithner is a financial industry representative planted in the White House to do Wall Street's bidding. Institutional bias precludes him from doing his job. That said, the first step in any financial rescue plan must be to hose down

Treasury, banish the fraudsters, and bring in a whole new economics team. That will pave the way for nationalizing the banks and providing debt-relief to the people who need it most, the victims of Wall Street's Ponzi-credit bubble scam.
