



# Geithner's 100 Days at Treasury

By Jim Genova

## Aggressive Action to Stem Financial Crisis, but to What End?

Most leading economists, international financial agencies, and heads of sovereign finance ministries agree with the assessment of the World Bank in its Global Monitoring Report 2009 (released April 2009) that the world economy is in the "severest crisis since the Great Depression." Moreover, the International Monetary Fund (IMF) recently issued its finding that the "advanced economies will suffer deep recessions in 2009" with any prospect of a "painfully slow" recovery pushed off to the second half of 2010 at the earliest. Even that positive evaluation is contingent on a variety of complex factors and coordinated global policy actions that the IMF readily admits are speculative, describing "the current outlook [as] exceptionally uncertain, with risks weighed to the downside."

It is in the midst of the maelstrom of the most significant contraction of the global economy in over 60 years that President Barack Obama elevated Timothy

Geithner from his post as President of the New York Federal Reserve Bank (the most powerful of the regional Fed Banks) to that of US Treasury Secretary, perhaps the most potent position in the world's economy. Since his appointment, Geithner has spearheaded a number of initiatives designed to stabilize the financial system, "restore confidence" in the markets, and mitigate the fallout in the "real economy" from Wall Street's woes. The result is an alphabet soup of complex programs that amount to pumping trillions of dollars into the banking sector in ways that forge tight partnerships between the government and some of the world's largest hedge funds, brokerage firms, and banks.

In an article published in the Financial Times April 23, 2009, Geithner writes, "The outlook [for the economy] is challenging, but we have not been idle. The global economy is projected to shrink this year for the first time in more than six decades. The collapse of world trade is expected to be the largest since the end of the Second World War. A global process of deleveraging is adversely affecting the

availability of financing domestically and internationally.” He concludes, “Our task in Washington is to keep at this process of repair and reform.” In fact, the flurry of activity at Treasury since Geithner’s appointment stands in stark contrast to the seeming paralysis under President Bush’s Treasury Secretary, Henry Paulson. Noted economist and former Clinton administration official Joseph Stiglitz observes, “President Bush seemed like a deer caught in the headlights – paralyzed, unable to do almost anything – for months before he left office.” He adds, “It is a relief that the US finally has a president who can act, and what he has been doing will make a big difference.” The question, then, is what difference will these actions make and to whose benefit.

A cursory glance at the Treasury Department’s website indicates the level of activity taken in the first 100 days of the Obama Administration to mitigate the collapse of the global capitalist financial system. To date, Treasury has launched the following programs under authority granted by Congress in October 2008 through the Emergency Economic Stabilization Act (EESA), which established the Troubled Assets Relief program (TARP):

1. Capital Assistance Program (CAP)
2. Consumer and Business Lending Initiative (CBLI)
3. Making Home Affordable Program (MHAP)
4. Public-Private Investment Program (PPIP)
5. Capital Purchase Program (CPP)
6. Asset Guarantee Program (AGP)
7. Targeted Investment Program (TIP)
8. Automotive Industry Financing Program (AIFP)

In addition, Geithner’s agency inherited the Systemically Significant

Failing Institution Program (SSFI), which currently holds American International Group (AIG) in receivership, but is also meant to deal with any institution that poses a systemic risk and is deemed “too big to fail.”

The centerpiece of Treasury’s strategy to combat the economic crisis is the Financial Stability Plan, which Geithner unveiled on March 31st. Reiterating the consensus assessment that we are in “the most severe financial crisis since the Great Depression,” Treasury vowed to deploy “our full arsenal to attack the credit crisis on all fronts.” This ambitious and unprecedented action includes some programs initiated under the TARP, thereby making use of funds already allocated by Congress, adding to them new initiatives that draw upon money made available through the Federal Reserve Bank (chaired by Ben Bernanke) combined with assets provided by private investors – large hedge funds, investment banks, mutual fund managers, and wealthy investors – thereby enabling Geithner to bypass the need for Congressional approval for additional financing.

The Financial Stability Plan covers four areas of the economic crisis through six distinct programs. The categories of concern are “a broad program to stabilize the housing market,” “a new capital program” for the banks, “a major new lending program ... targeted at the securitization markets critical for consumer and small business lending,” and “a program to set up funds to provide a market for the legacy loans and securities that currently burden the financial system,” i.e. the now infamous “toxic assets.” Treasury hopes to address problems in those four areas through six initiatives: Financial Stability Trust (including “a comprehensive stress test for major banks,” “increased balance sheet transparency and disclosure,”

and use the CAP from the TARP); P-PIP (the toxic asset plan set with an initial price target between \$500 billion and \$1 trillion); CBLI (from the TARP) using up to \$1 trillion; “transparency and accountability agenda – including dividend limitation;” the MHAP (President Obama’s plan to stem foreclosures in the housing market, which was doubled just this week); and “a Small Business and Community Lending Initiative.”

Operating from the assumption that a major component of the current financial debacle is a “crisis of confidence,” Treasury sees restoring “financial stability trust” as its top priority. To do so, it is requiring all banks with assets in excess of \$100 billion (amounting to 19 financial institutions by most accounts) to undergo “a comprehensive stress test” to determine what capital needs (if any) banks may face in the event of an even steeper downturn in the economy in the future. The results of those tests are expected to be released in some form after May 4th. This program has been greeted with a mix of cynicism and worry by analysts, Wall Street, and the general public. Some believe the stress test is little more than a whitewash giving notoriously insolvent banks (like Bank of America and Citigroup) clean bills of health, thus restoring “confidence” in the financial system, which in turn will spur more consumer spending and (most importantly) more investment in the stock market. Others are concerned that the stress test is serious and that some banks (again, the two noted above are frequently mentioned) may fail, requiring them to raise more capital or seek more Federal assistance, neither of which will spur confidence in the market. Treasury has made funds available from the Capital Assistance Program under the TARP to meet the capitalization needs of the banks. Those funds will come in the form of stock

purchases at a price set near that posted on the stock exchange on February 9, 2009, just prior to the last swoon in the market. Finally, there has been some concern that the Treasury Department will only reveal that most banks are “well-capitalized,” inducing confusion as analysts and those with deposits at major banks seek to identify those that are not well-capitalized.

In the midst of the stress tests, though, regulators voted to change the accounting rules governing how banks report their earnings and losses. Previously, banks were required to mark all of their assets (performing and non-performing) to the market price at the date of reporting, the so-called mark-to-market accounting rule. This forced banks to report their toxic assets as essentially worthless since there was no market for them (hence their toxicity). Under the new rules, the banks can designate what they believe their assets are “really” worth, even if there is no market price for them. Thus, they can take a bundle of loans in default, mortgages in foreclosure, and credit cards that are delinquent and assess a value on them of the bank’s own choosing. Suddenly, those steep losses on the bank’s balance sheets turn to profits – hence the recent spate of uplifting earnings news from the likes of JP Morgan Chase, Wells Fargo and Goldman Sachs who reported record or near-record profits in the first quarter of 2009. Another factor enabling the banks to cook the books is that they can count TARP and other Federal funds as assets – even if they are not lending them out as intended by the congressionally-authorized programs. Finally, those banks that received Fed funds at effectively zero percent interest and loaned them out (in the form of credit cards, etc.) have raised their fees and the interest rates they charge to working people across the country. Thus, it is impossible for the banks not make record profits even as the

public is gouged and the treasury drained of much-needed funds while the economy continues to deteriorate. It is no wonder some have cast a jaundiced eye at the significance of the stress tests.

The next major component of the Treasury's strategy for stabilizing financial markets is the Public-Private Investment Program (P-PIP), announced in March and widely believed to be the spur behind the recent run-up in the US stock market. This program commits up to \$1 trillion in public and private money in initial funds to lift the toxic assets off the books of the major banks and create a market for their sale to willing investors. This controversial plan commits the US government to provide financial backing, loss guarantees, and leverage for private investors (mostly some of the world's largest hedge funds) who then manage the sale of these worthless assets. The Treasury Department and Federal Reserve commit to put up an initial \$100 billion (from remaining TARP funds) that will be matched by an equivalent amount of private capital that is then leveraged at a rate of up to six-to-one. That means if a large hedge fund commits to purchase toxic assets from a major bank and advances \$100 billion, the US government, through the Federal Deposit Insurance Corporation (FDIC), agrees to loan an additional \$600 billion to the hedge fund to complete the purchase. This is a standard Wall Street practice used to boost the revenues of banks (who collect fees for their provision of capital) and inflate stock prices, enabling a fund to buy six times the amount of assets it otherwise would be able to do with the cash available on hand. The bet is that the price will rise enough in a set time enabling the borrower to pay back the margin, recover their initial investment, and make a profit – far out of proportion to the actual capital risked. The difference in this program is that instead of a private bank

forwarding the money and taking the risk of losing the leveraged cash, the US government is absorbing all the risk, with only the hedge fund's initial capital at risk for the private investor.

Once the initial funds have been arranged, banks with "legacy assets" can voluntarily sell them to the P-PIF (the fund created by the program). The bank will take a small loss – perhaps as much as twenty cents on the dollar – but gains the twin benefits of a write off (lowering their tax burdens) and removing worthless assets from their balance sheets, thus making the banks appear to be more solvent than they actually are (another complex accounting trick meant to "revive public confidence" in the banking system). The bad assets are then managed by the private investor – the government has no say in the pricing of the assets or in control of their distribution, even though most of the money enabling the purchase is from public funds. The hedge fund managers then package these bad debts and sell them to others willing to take on very risky bets. Any profits go to the fund manager (who also collects transaction fees), while the government hopes for at best a small return, but more likely it will eat significant losses. This program is very exciting for Wall Street on a variety of levels. Big fund managers and financial institutions can now freely gamble with public money at very little private risk. The banks suddenly gain the appearance of remarkable health. The bad assets remain just that – a home in foreclosure and credit cards in default remain so, they don't magically disappear into the accounting ether. This program was aimed squarely at Wall Street in a crude attempt to cause a rally in the stock market, on which score it has been successful, at least for now.

The next leg in the Financial Stability Plan is the "consumer and Business Lending Initiative" at a price tag

of up to \$1 trillion. This program targets the “frozen credit markets” that caused the global economy to go into a near comatose state in September and October of 2008. Despite a plethora of injections of capital, historic cuts in interest rates (to near zero in the US on the Fed Funds Rate), and a dramatic expansion in the size of the Fed’s balance sheet (now well over \$2 trillion from a “normal” level of under \$500 billion) the credit markets have remained largely seized. This aspect of the Treasury’s strategy builds on the long-anticipated Term Asset-Backed Securities Loan Facility (TALF), promised by Paulson in the Bush administration, and now being implemented under Geithner and the Obama administration. The money earmarked for this program will be used to “support the purchase of loans by providing the financing to private investors to help unfreeze and lower interest rates for auto, small business, credit card, and other consumer and business credit.” Geithner explains that the TALF was initially set to use \$20 billion from Treasury to leverage \$200 billion from the Federal Reserve. Now those figures have been expanded to \$100 billion from Treasury to leverage \$1 trillion from the Federal Reserve: a fivefold increase. Again, private investors will get this money (at near zero percent interest) to purchase loans, package them together, and sell them on the open market. This was one of the key elements of neo-liberal globalization in the 1990s and 2000s, and a very lucrative business where the risks were significant, but the potential returns in trading on debt were stratospheric. Now the government will, again, absorb the risk and allow private investors to rebuild their market, having basically wrecked the global economy through these exact activities in the past.

To avoid some of the pitfalls evident in the very practices Treasury seeks

to revive, Geithner’s Financial Stabilization Plan calls for some sweeping reforms in the financial sector as a fourth pillar of the strategy. Criticizing the initial outlay of \$350 billion in TARP funds under Paulson’s watch for its lack of conditionality (basically it was free money to the banks with which they could do whatever crossed their minds, including acquiring their rivals and going on splendid vacations), Geithner has called for a “new era of transparency, accountability, monitoring, and conditions.” Banks receiving Federal funds will now be required to submit plans clearly outlining how they intend to use the money. Specifically, they have to show how the new capital will help improve the bank’s ability to make new loans or preserve existing loans. They will also be required to submit monthly reports to Treasury, so that their lending activity can be monitored. Those reports will be posted on the Treasury Department’s website ([FinancialStability.gov](http://FinancialStability.gov)) enabling the public to also hold the banks and government accountable. Additionally, banks that receive government cash must participate in mortgage foreclosure mitigation programs under supervision of Fannie Mae and Freddie Mac (seized by the government in September 2008). Banks will also have imposed on them restrictions on the size of dividends paid to shareholders (usually at a rate of \$0.01 per common share each quarter), they cannot repurchase shares of stock (a tactic used to boost share prices on the stock market), and they are banned from acquiring other financial institutions. Executive compensation limits will be strictly set at \$500,000 until the money is repaid and boards must include “say on pay” shareholder votes in their annual meetings. Although, it should be mentioned at this point that while the boards have complied and placed “say on pay” on the

ballots, they also recommend shareholders vote against that provision. Since most common shareholders simply vote “for all board recommendations,” fearing that they do not know enough to go against those running the company, those ballot measures are almost certain to go down to defeat.

The next pillar of the Geithner Plan concerns support for the housing sector through the “Making Housing Affordable Program.” The Treasury Department will partner with the Federal Reserve to use \$600 billion to purchase mortgage-backed securities (the debt instruments traded around the world that caused a catastrophic market sell-off once housing prices began a precipitous decline, eroding the values of the securities). This is designed to “cram down” mortgage rates enabling households to refinance under lower interest – although the terms of their mortgages will (naturally) expand to upwards of 40 years, making the cost of the house to the homeowner much greater in the long term. Treasury has also committed \$50 billion to prevent foreclosures by assisting homeowners on the verge of becoming delinquent to refinance by reducing monthly payments, again involving a lengthening of the terms of the mortgage. This will help some people stay in their homes for a bit longer than they otherwise would have. However, evidence since the program went into effect in March suggests that the most vulnerable are receiving the least help and foreclosure rates are on the rise (though White House officials are working on ways to expand eligibility). The banks, meanwhile, are raking in huge profits through the fees they collect for each mortgage transaction, which is the way banks typically profit from the mortgage business. They are not interested in whether the homeowner can fully repay the mortgage in 30 years. In fact, the banks typically sell the mortgages as soon as they are signed, collecting the

fees (closing costs, etc.) and freeing up more capital to replicate the process with another homeowner.

The final piece of the puzzle is the “Small Business and Community Lending Initiative,” which will commit public money to back loans made to small businesses that otherwise cannot secure them from the frozen credit markets. The government is seeking authority from Congress to increase its liability from 75 percent to 90 percent, thereby taking over a key lending activity no longer being conducted by the private banking sector. This will enable small businesses to meet payrolls, purchase inventory, and roll over existing debt to stay in business. This is a preventative strategy hoping to stem the rate of bankruptcies and job losses in the economy.

When the Geithner Plan was first announced on February 10, 2009 traders on Wall Street sent stock prices tumbling for the next month. The general accusation was that the Treasury Secretary appeared “nervous” and lacked “confidence.” Others emphasized the lack of “detail,” particularly concerning the strategy for dealing with the banks’ toxic assets. This is a classic example of deliberate capital flight and capital destruction, a tactic used by monopolistic finance capital frequently to “chasten” any government that appears to be intruding into the sacred practices of “free market” capitalism. Bankers in France did it following the Popular Front’s victory in 1936 and eventually caused such a financial crisis that the currency had to be devalued and the reforms launched by the leftist coalition were stopped; then rolled back. Bankers in the US did it twice during the Great Depression, first to forestall FDR’s initial public works program and system of regulation for the banking sector, then again in the late 1930s when the government passed legislation expanding

trade union rights and mandated collective bargaining. There are innumerable cases of the most powerful sectors of capitalism using their main weapon – money – in order to preserve their class position or vastly expand their control over society. The selloff in the stock market between February 10th and March 9th was precisely such an event. The target was the Obama administration itself, accusing it of having an “anti-business” bias and that it was bent on “nationalizing” the banks, perhaps even ending capitalism itself. As ludicrous as the accusations were, they did receive extensive media play (most notoriously on CNBC where correspondent Rick Santelli caused a near riot on the floor of the Chicago Mercantile Exchange that led to the April 15th anti-tax “tea party” protests around the US). In the process, retirees took another hit to their pensions, more small businesses and small farmers were pushed to the brink, and the public’s “confidence” level continued to plunge.

Geithner, it seems, got the message. Over the weekend of March 7-8th, he met with top bankers, Fed Chair Ben Bernanke, and leading hedge fund managers to devise the P-PIP. After he unveiled the plan, on March 9th, for the government to absorb all the risks of worthless assets and transfer from \$1 to \$2 trillion to private hedge fund managers at no cost to them the stock market soared and has continued to move upward (as of this writing at the end of April) ever since. The flight of capital was over. Wall Street believed the threat of nationalization of the banks was over, the government was committed to spend any amount of money will little accountability to keep monopoly finance capital alive, and the accounting rules would be loosened to allow the holders of bad assets to set their own price – a recipe for future financial catastrophe since the model articulated through the rules changes is that

methodology used by Enron in the 1990s to cook its books.

To date, Geithner’s record at Treasury is mixed. He deserves some credit for facilitating loans to small businesses and, most importantly, for the oversight and monitoring of the banks’ actions once they have received Federal money through the TARP. Moreover, there has been some effort to make bankers accountable and reign in their ludicrous salaries. However, on this score both the Wall Street Journal and New York Times reported this week that Wall Street and banking executive compensation is once again approaching 2007 (pre-crisis) levels – despite all the restrictions. The housing plan will certainly help a few people stay in their homes a bit longer, but it is universally acknowledged to be a stop-gap measure requiring more substantive follow through and structural reform, which is not yet on the agenda. However, if one weighs the balance of fund allocation it is clear the big winners are those who caused the crisis in the first place. Nearly \$3 trillion in public money is to be transferred to the most powerful, wealthiest capitalist institutions with only symbolic strings attached (as well as some fishy accounting rule changes to benefit the banks along the way). This is extremely dangerous for working people who are having their own incomes destroyed, their jobs threatened, and their homes foreclosed. On top of those burdens, the result of the rapacious greed at the heart of the capitalist system, working people are being saddled with immense financial risk, loss of revenue in the hands of the government that will surely be needed for social programs and stimulus spending, and insurmountable debt that could cripple the government’s capacity to invest for society’s benefit and meet existing obligations (like payroll, for example).

To understand the class implications of the current government strategy for overcoming the economic crisis one need look no further than a comparison of the commitments made in the American Recovery and Reinvestment Act (the stimulus) and that made as part of Geithner's Financial Stability Plan. While Congress managed to allot roughly \$800 billion in economic stimulus (about 40 percent of which was in the form of tax cuts), Geithner's P-PIP alone begins with a minimum figure of \$1 trillion and expects to climb to \$2 trillion. According to the IMF, U.S. banks are actually on the hook for nearly \$3 trillion in "toxic assets," suggesting that even Treasury's initial figures might be conservative. In any event, a few hundred billion dollars have been specifically allocated for public works while around \$4 trillion has been directly transferred to major private financial institutions. Paul Krugman, Joseph Stiglitz, David Harvey, and other leading economists and analysts agree that this siphoning of funds contributes to widening disparities in wealth, greater power concentration in the hands of the capitalist class, and undermines the ability of working people to draw upon their own national resources to resist corporate power. As Stiglitz notes recently in Project Syndicate, "Socializing losses while privatizing gains is more worrisome than the consequences of nationalizing banks. ... Confidence is important, but it must rest on sound fundamentals."

It will require a massive mobilization of working people, small farmers, the middle class and their allies to counteract the nefarious influence of monopoly finance capital at Treasury and forestall this unprecedented transfer of wealth from the people to those responsible for dragging hundreds of millions of people around the world into poverty. (The World

Bank estimates already that 55 million people have been thrown into poverty that otherwise would not have been in that state.) Moreover, the current crisis requires a greater level of international cooperation and coordination, not just at the government level, but more importantly in the streets. Along with the lessons of past catastrophic capital flights engineered by capitalists seeking to protect or advance their class interests, history also points to examples of popular mobilizations to overcome those anti-people and socially devastating attacks. It is well for us to remember that without sustained, militant grassroots action by workers across the US in the 1930s, the pro-labor legislation and New Deal programs that were passed would likely have been destroyed or blocked as finance capital sought to torpedo the economy by contracting the money supply. It is in crises like these that the lines of the class struggle are more sharply drawn, the stakes are elevated, and the desperation of the ruling class at the perceived threat to its dominance leads to vicious, extremist tactics to undermine popular will and "hope" that an alternative society can be built. In recent months demonstrations against the G20, the corrupt managers of AIG, and to prevent plant closings and evictions around the world have shown that the class struggle is not one sided and that working people are mobilizing to fight for a better, more sustainable way of life. It is a fight for the destiny of humanity itself.