Bailout Baloney - Banking

More than a year has elapsed since the U.S. economy went into a tailspin with the panic that shook the world's financial markets in the fall of 2008. Two presidential administrations have attempted to solve the crisis by political means, using taxpayer dollars to bail out certain corporations deemed too large or too critical to be allowed to fail.

Funds were made available to the entire banking sector, to the insurance behemoth AIG, and to the Big Three American automotive corporations, and all of them came with numerous strings attached: In exchange for a new lease on life, America's corporate behemoths came under the direct control, and, in many cases, even ownership, of the federal government.

The year that followed was deemed a success by Obama administration spinmeisters, who cited evidence of the recession's end and a return to growth. The decisive actions of President Obama, Treasury Secretary Timothy Geithner, and Federal Reserve Chairman Ben Bernanke have been credited with saving the country and the world from an all-out meltdown; the bailouts, politically unpopular then as now, were a necessary evil to prevent a greater crisis from developing, or so we have been told. But with the lapse of time, the real cost of the bailouts is becoming clear — even as the Obama administration and its allies in Congress clamor for more.

What Transpired Under TARP

The general public still has a very murky view of the Troubled Asset Relief Program (TARP) launched in October 2008 at the height of the financial crisis. The banking sector, however, labors under no such misapprehensions. Characterizing TARP as "a lousy program," Minneapolis-based US Bancorp CEO Richard Davis opined last year that "there's no A, R, or P in TARP." According to an article in last year's *San Francisco Business Times*, "The problems with the U.S. Treasury Department's program are that its goals and rules have changed since its inception … it's poorly defined and it's caused collateral damage to healthy banks." If this was true almost a year ago, it's even more so now, with the country moving into its third year of recession and no end in sight to high unemployment, business closings, and — despite more than a year of government involvement in the banking sector — large numbers of banks teetering on the brink of insolvency.

First, a public's-eye view of what transpired in those never-to-be-forgotten months when some of the most storied names in banking and finance — Leh-man Brothers, Merrill Lynch, Washington Mutual, and many others — were brought to their knees in the swiftest implosion of the American financial system since the Panic of 1907. The Troubled Asset Relief Program in all its $700 billion excess was rushed through Congress, with lawmakers and citizens alike chafing at the crippling cost. Many believed — mistakenly — that the benefit of such a measure outweighed the risks of doing nothing, and so yet another slab of corporate welfare was inflicted on American taxpayers. The atmosphere of panic soon dissipated, and America breathed a sigh of relief. Billions of government dollars flowed into the coffers of big banks, and the specter of an all-out "banker's panic" receded. More recently has come the news that banks are repaying TARP funds, and the government is supposedly making a profit on the venture.

But the real story of the bank bailouts is rather more nuanced. The centerpiece of the bank bailouts has been the Capital Purchase Program (CPP), which was touted at its inception in October 2008 as a way to "stabilize the financial system by providing capital to viable financial institutions of all sizes throughout the nation." $250 billion in TARP funds were made available, of which a total of roughly $205 billion has been doled out to more than 700 different banks of all sizes. Investment banks, credit card companies, and even insurance companies have been allowed to transform themselves into bank holding companies in order to participate in the program. In exchange for government funds, participating banks were required to sell preferred shares of stock to the federal government, for which they were required to pay a five percent annual dividend for the first five years, and nine percent after that. Additionally, federal regulators and auditors now have considerable say-so over the internal decision-making at many participating institutions, including whether to pay executive bonuses or shareholder dividends. The government, not surprisingly, is jealous of its new investments.

Badgering the Banks

The Capital Purchase Program was proclaimed to be voluntary, but, according to industry insiders, it was anything but. In the weeks after the CPP's inception, armies of federal regulators fanned out across the country, approaching executives at banks large and small, and arm-twisting many of them into the program. In theory at least, since the entire system was at risk, it was the moral responsibility of all banks, healthy or otherwise, to participate, to avoid unfair stigmatizing. But in practice, the CPP has proven to be a tar baby that practically no one in the banking industry wants, but from which too few institutions have managed to extricate themselves altogether.

"We tried to stay out of the program," an officer at M&T Bank, a large regional bank based out of Buffalo, New York, told this author. "We never got into trouble with risky real estate deals, and our portfolio was healthy. But the government more or less coerced us into participating." M&T reluctantly decided to accept the funds, but to set them aside without using them and tried to give them back almost immediately. However, they were not allowed to do so by their new federal government taskmasters, and have ended up paying the dividend rates and other costs for participating in a program that they neither wanted nor needed. "I was told that the paperwork to get out of the program was much, much harder than to get in," an executive at another regional bank said recently, confirming that his institution, too, had been more or less compelled to participate, despite being financially sound.

A large number of the institutions pressed into involvement with the CPP appear to have had no use for it in the first place, and are pulling out all the stops to get out of the program, with its baneful drag on corporate finances and limits on institutional autonomy. The recent parade of stories about successful repayments of CPP funds must therefore be taken with at least a partial grain of salt. Many of these repayments do not represent sick institutions returned to robust health thanks to the magic of government intervention; they represent instead banks that were healthy to begin with paying lots of money to the government to get out of obligations they neither needed nor sought in the first place.

What's more, the CPP was advertised as a program for "healthy" institutions who were caught up by unforeseen hardship. All rhetoric aside, however, it clearly was and remains a bailout for a few terminally ill financials — who should have been allowed to fail and be bought up by healthier institutions — at the expense of everyone else.

How's It Helping?

So what is the status of the banking sector, more than a year after the inauguration of the grand $250 billion CPP "bailout-that-wasn't"?

Hundreds of bank holding corporations remain under the control of the federal government, and the lending climate remains as shaky as ever. Since the beginning of 2010, 15 banks have already failed, according to the FDIC — six of them on Friday, January 29. On that day, FDIC regulators swooped in and closed the doors of First Regional Bank in Los Angeles, Florida Community Bank, First National Bank of Georgia, American Marine Bank in Washington, Marshall Bank in Minnesota, and Community Bank and Trust in Georgia, with a combined asset value of about $5.2 billion. Although the assets of all of these institutions have been acquired by healthier banks, the FDIC is clearly worried. "The FDIC expects 2010 to be a peak for bank failures as a result of the financial crisis. Last year, 140 banks failed, compared to 25 in 2008 and three in 2007," the *Economic Times* reported on January 31. "The FDIC has said it expects the total bill for bank failures to reach $100 billion for the period of 2009 through 2013." In other words, the worst is likely yet to come — and will not be long delayed — for the banking sector.

Much of this is not necessarily bad news, however; the fact that the economy continues to wallow in recession and credit remains dried up suggests that, despite all of the federal government's efforts to reinflate the bubble economy, the long-overdue economic correction is running its course. That corrective process, unfortunately, is likely to take some years yet, because of the dogged efforts of politicians and central bankers to thwart the laws of economics.

None of this has deterred the politicians from staying the interventionist course, naturally enough; on February 2, President Obama announced yet another creative outlet for taxpayer dollars, a brand new $30 billion initiative aimed at encouraging banks to loan to small businesses willing to add new employees to their payrolls. The President also proposed on February 1 to raise the FDIC's required level of reserves to more than $80 billion, which will mean significant FDIC insurance premium hikes for banks to absorb.

The lesson learned from both the Great Depression and the ongoing epochal recession (whatever it ends up being called in the history books) is that modern economic crises are far more political than economic or financial. The severity of the current downturn is a consequence of decades of economic distortion by government and central bankers, who insisted on "forever blowing bubbles," erecting an economic order on easy money and credit instead of sound money and fiscal restraint. Not only that, but — as in the 1930s — this crisis is being prolonged, perhaps for many years yet to come, by a policy of more of the same. The trillions of dollars of new debt incurred by the government's feckless attempts to bail out everyone but the American taxpayer will have to be repaid; until they are, the economy will be hamstrung by interest payments alone.

Yet little is likely to change until American voters and taxpayers insist of their elected representatives that they put the "free" back in "free market."

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