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Banking by John Hoefle

Taxpayers to foot bailout bill

The loudly touted plan for the banks to bail themselves out is another hoax, backed by the Bush administration.

The Bush administration, the Congress, and the major banking trade associations have been loudly proclaiming to everyone who would listen that the taxpayers will not be called upon to bail out the commercial banks. "The banks are not the S&Ls," they hysterically insist.

To work out the details of how the banking system would rescue itself, government regulators, and representatives of the American Bankers Association, the Association of Bank Holding Companies, the Association of Reserve City Bankers, the Consumer Bankers Association, and the Independent Bankers Association of America held a series of banking summit meetings in Washington in February.

Amid much fanfare, the bankers released a plan to recapitalize the Federal Deposit Insurance Corp. by lending the agency $10 billion. This plan, the bankers insisted, would rescue the FDIC at no cost to the taxpayers. What the plan actually says is just the opposite.

In a letter to FDIC chairman William Seidman dated Feb. 12, the five banking groups argue that while the Bank Insurance Fund "may need additional funds . . . it would not make sense to draw large amounts of funds from the industry for recapitalization before it is clear that those funds are needed. . . . Since large new recapitalization funding would effectively come from bank capital, resulting in shrinkage of that capital, the result would be a further contraction of credit, exacerbating the recession and resulting in additional bank failures. It would obviously be counterproductive to require massive additional funding that may well turn out not to be needed."

What outrageous lying! The Bank Insurance Fund is projected by the FDIC to have no more than 11¢ in insurance funds for every $100 in insured deposits at the end of this year, while federal law requires it to have $1.25 in funds for every $100. To argue that it is not yet clear that the FDIC needs additional money, is blatantly dishonest.

That's not the worst of it. After complaining that the cost of the government's "too big to fail" policy of protecting 100% of deposits at the biggest banks is too costly, the letter continues: "We, understandably, are unwilling to continue to underwrite these unnecessary costs. . . . The use of a too-big-to-fail policy to prevent systemic risk is not a legitimate function of deposit insurance. In fact, the FDIC system was never designed to deal with such systemic risk. We believe that the costs of dealing with systemic risks, as was the case with Chrysler, Lockheed, and New York City, should be borne elsewhere."

For the bankers to rail against "too big to fail" is sheer hypocrisy, since the function of "too big to fail"—and deposit insurance in general—is to protect the banking system itself, not depositors. To quote the Treasury's own recent bank reform proposal, "The primary purpose of deposit insurance is to promote financial stability by preventing destructive bank deposit runs."

Finally, we get to the heart of the bankers' proposal: The costs of "systemic risks" should be borne by the government. What the bankers' plan boils down to is: The taxpayers should bail out the banking system.

Not everyone is fooled by this nonsense. The plan is a "public relations smoke screen designed to hide the fact that banks may soon be at the federal welfare window," said House Banking Committee chairman Henry Gonzalez (D-Tex.). "The administration, not the banking lobbyists, needs to submit the details of any plan for bailing out the bank insurance fund."

The Bush administration, however, is committed to covering up the insolvency of the banking system. The Treasury Department, over the reported objections of federal regulators, is moving to allow banks to use a number of bookkeeping tricks to make their balance sheets appear less deficient, and Federal Reserve chairman Alan Greenspan has publicly castigated federal bank examiners for doing their jobs too well.

These tricks include allowing banks to claim parts of non-performing loans as being performing, valuing real estate on its alleged "long-term" value rather than at market value, and reducing the amount of money banks have to set aside on so-called "temporarily impaired" real estate loans.

These schemes represent "a way to deal with the reality of a downturn or a recession, without throwing the banking institutions, unfairly or unrealistically, into panic," Commerce Secretary Robert Mosbacher said in Miami Feb. 1.

Quite the contrary, Mr. Mosbacher. All the administration is doing is ignoring the problems, because it has neither the competence nor the morality to deal with them. That is what is unfair and unrealistic, and the American public will pay a heavy price for tolerating such idiocy.

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