Geithner's 'Dirty Little Secret': The Entire Global Financial System is at Risk

When the Solution to the Financial Crisis becomes the Cause

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US Treasury Secretary Tim Geithner has unveiled his long-awaited plan to put the US banking system back in order. In doing so, he has refused to tell the 'dirty little secret' of the present financial crisis. By refusing to do so, he is trying to save de facto bankrupt US banks that threaten to bring the entire global system down in a new more devastating phase of wealth destruction.

The Geithner Plan, his so-called Public-Private Partnership Investment Program or PPPIP, as we have noted previously is designed not to restore a healthy lending system which would funnel credit to business and consumers. Rather it is yet another intricate scheme to pour even more hundreds of billions directly to the leading banks and Wall Street firms responsible for the current mess in world credit markets without demanding they change their business model. Yet, one might say, won't this eventually help the problem by getting the banks back to health?

Not the way the Obama Administration is proceeding. In defending his plan on US TV recently, Geithner, a protégé of Henry Kissinger who previously was CEO of the New York Federal Reserve Bank, argued that his intent was 'not to sustain weak banks at the expense of strong.' Yet this is precisely what the PPPIP does. The weak banks are the five largest banks in the system.

The 'dirty little secret' which Geithner is going to great degrees to obscure from the public is very simple. There are only at most perhaps five US banks which are the source of the toxic poison that is causing such dislocation in the world financial system. What Geithner is desperately trying to protect is that reality. The heart of the present problem and the reason ordinary loan losses as in prior bank crises are not the problem, is a variety of exotic financial derivatives, most especially so-called Credit Default Swaps.

In 2000 the Clinton Administration then-Treasury Secretary was a man named Larry Summers. Summers had just been promoted from No. 2 under Wall Street Goldman Sachs banker Robert Rubin to be No. 1 when Rubin left Washington to take up the post of Vice Chairman of Citigroup. As I describe in detail in my new book, ***Power of Money: The Rise and Fall of the American Century***, to be released this summer, Summers convinced President Bill Clinton to sign several Republican bills into law which opened the floodgates for banks to abuse their powers. The fact that the Wall Street big banks spent some $5 billion in lobbying for these changes after 1998 was likely not lost on Clinton.

One significant law was the repeal of the 1933 Depression-era Glass-Steagall Act that prohibited mergers of commercial banks, insurance companies and brokerage firms like Merrill Lynch or Goldman Sachs. A second law backed by Treasury Secretary Summers in 2000 was an obscure but deadly important Commodity Futures Modernization Act of 2000. That law prevented the responsible US Government regulatory agency, Commodity Futures Trading Corporation (CFTC), from having any oversight over the trading of financial derivatives. The new CFMA law stipulated that so-called Over-the-Counter (OTC) derivatives like Credit Default Swaps, such as those involved in the AIG insurance disaster, (which investor Warren Buffett once called 'weapons of mass financial destruction'), be free from Government regulation.

At the time Summers was busy opening the floodgates of financial abuse for the Wall Street Money Trust, his assistant was none other than Tim Geithner, the man who today is US Treasury Secretary. Today, Geithner's old boss, Larry Summers, is President Obama's chief economic adviser, as head of the White House Economic Council. To have Geithner and Summers responsible for cleaning up the financial mess is tantamount to putting the proverbial fox in to guard the henhouse.

The 'Dirty Little Secret'

What Geithner does not want the public to understand, his 'dirty little secret' is that the repeal of Glass-Steagall and the passage of the Commodity Futures Modernization Act in 2000 allowed the creation of a tiny handful of banks that would virtually monopolize key parts of the global 'off-balance sheet' or Over-The-Counter derivatives issuance.

Today five US banks according to data in the just-released Federal Office of Comptroller of the Currency's Quarterly Report on Bank Trading and Derivatives Activity, hold 96% of all US bank derivatives positions in terms of nominal values, and an eye-popping 81% of the total net credit risk exposure in event of default.

The five are, in declining order of importance: JPMorgan Chase which holds a staggering $88 trillion in derivatives (€66 trillion!). Morgan Chase is followed by Bank of America with $38 trillion in derivatives, and Citibank with $32 trillion. Number four in the derivatives sweepstakes is Goldman Sachs with a 'mere' $30 trillion in derivatives. Number five, the merged Wells Fargo-Wachovia Bank, drops dramatically in size to $5 trillion. Number six, Britain's HSBC Bank USA has $3.7 trillion.

After that the size of US bank exposure to these explosive off-balance-sheet unregulated derivative obligations falls off dramatically. Just to underscore the magnitude, trillion is written 1,000,000,000,000. Continuing to pour taxpayer money into these five banks without changing their operating system, is tantamount to treating an alcoholic with unlimited free booze.

The Government bailouts of AIG to over $180 billion to date has primarily gone to pay off AIG's Credit Default Swap obligations to counterparty gamblers Goldman Sachs, Citibank, JP Morgan Chase, Bank of America, the banks who believe they are 'too big to fail.' In effect, these five institutions today believe they are so large that they can dictate the policy of the Federal Government. Some have called it a bankers' coup d'etat. It definitely is not healthy.

This is Geithner's and Wall Street's Dirty Little Secret that they desperately try to hide because it would focus voter attention on real solutions. The Federal Government has long had laws in place to deal with insolvent banks. The FDIC places the bank into receivership, its assets and liabilities are sorted out by independent audit. The irresponsible management is purged, stockholders lose and the purged bank is eventually split into smaller units and when healthy, sold to the public. The power of the five mega banks to blackmail the entire nation would thereby be cut down to size. Ooohh. Uh Huh?

This is what Wall Street and Geithner are frantically trying to prevent. The problem is concentrated in these five large banks. The financial cancer must be isolated and contained by Federal agency in order for the host, the real economy, to return to healthy function.

This is what must be put into bankruptcy receivership, or nationalization. Every hour the Obama Administration delays that, and refuses to demand full independent government audit of the true solvency or insolvency of these five or so banks, inevitably costs to the US and to the world economy will snowball as derivatives losses explode. That is pre-programmed as worsening economic recession mean corporate bankruptcies are rising, home mortgage defaults are exploding, unemployment is shooting up. This is a situation that is deliberately being allowed to run out of (responsible Government) control by Treasury Secretary Geithner, Summers and ultimately the President, whether or not he has taken the time to grasp what is at stake.

Once the five problem banks have been put into isolation by the FDIC and the Treasury, the Administration must introduce legislation to immediately repeal the Larry Summers bank deregulation including restore Glass-Steagall and repeal the Commodity Futures Modernization Act of 2000 that allowed the present criminal abuse of the banking trust. Then serious financial reform can begin to be discussed, starting with steps to 'federalize' the Federal Reserve and take the power of money out of the hands of private bankers such as JP Morgan Chase, Citibank or Goldman Sachs.

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