German cabinet agrees “bad banks” plan for unloading “toxic assets”

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The German cabinet on Wednesday agreed a plan allowing the setting up of “bad banks” to encourage German banks to clear their accounts of junk bonds and “toxic assets”. The proposal put forward by Finance Minister Peer Steinbrück (Social Democratic Party, SPD) is the latest in a series of measures adopted by the German government to bail out the country’s banking and finance system.

Last autumn the government rapidly pushed through parliament an initial €500 billion bailout fund and set up the bank rescue fund known as Soffin. The government will put its latest plan before the German parliament within the next few weeks in order to ensure the measure is ratified before the summer recess and this autumn’s federal election.

Domestic pressure for further aid to German banks mounted when the true extent of their involvement in toxic investments was revealed. In April, the *Süddeutsche Zeitung* revealed the contents of an internal memo from the German banking regulator (Bafin), which estimated the extent of debt to be written off by German banks at €853 billion (US$1.1 trillion). Leading Bafin officials vigorously protested against the leak to the media and even sought to take legal action against publication of the details, but the cat was already out of the sack.

One of the prime candidates for participation in Steinbrück’s scheme is the Commerzbank, which announced earlier this year that its toxic assets totalled more than €50 billion ($68 billion).

The “bad bank” plan agreed on Wednesday by the German cabinet differs in several respects from the measures introduced by the US and British governments. Indeed, just yesterday Steinbrück dismissed US “stress tests” as a precondition for inclusion in the US bank bailout plan as “worthless”.

Steinbrück’s proposal involves the creation of a number of small “bad banks”. Banks are encouraged to set up their own companies to deposit their toxic wastes. The new companies would then refinance these junk bonds by issuing bonds to the mother bank. These toxic assets can then be exchanged, for an annual fee, for state-guaranteed bonds issued by Germany’s bank rescue agency, Soffin.

The entire process of allegedly cleaning up the banks is envisaged to take place over a period of 20 years. At the same time, participation in the Steinbrück plan is entirely voluntary. The proposal from one SPD finance expert that the government’s “bad banks” policy be made obligatory was struck down following a wave of opposition from bank CEOs.

In a series of interviews with the press Steinbrück has repeatedly stressed that the main advantage of his plan compared to US and American solutions is that it does not represent a burden on German taxpayers.

Steinbrück’s claim is baseless. In fact, the complex system for shuffling money from one bank to another has been developed precisely to hoodwink the German public in an election year. When the plan was first announced in April, the *Financial Times* quoted one source close to the German government who said, “In the end, the government, meaning the taxpayer, will be covering most of the losses—there’s no way around that, and it does not make the plan an easy sell when there’s a general election five months away.”

Less than a month later the government faces fresh evidence of the extent of the finance crisis. The working group Steuerschätzung estimated on Thursday that the total deficit in all federal, state and local treasuries due to the recession and plummeting tax receipts would total €316 billion by the 2013. The worsening economic data has not made it any easier for the German government when it comes to bailing out the banks. The trade newspaper *Handelsblatt* wrote this week that if the government had unloaded the full burden of its bank

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rescue package on the taxpayer it "would have provoked a popular uprising". What was needed, the paper went on, was a solution that "appeared fair and corresponded to free market principles".

This is exactly what Steinbrück has delivered—although the "appearance of fairness" is only possible because his measure also has the support of all the German opposition political parties.

Ultimately, responsibility for the implementation of the "bad bank" policy rests with Soffin, i.e., the German treasury and taxpayer. According to the Steinbrück scheme, the Commerzbank—with an estimated €50 billion in bad debts—would be required to pay off an average sum of €2.5 billion per year for the next 20 years to return to health. This is only possible, however, if the bank makes double-digit profits every year for the next two decades—i.e., that it carry out precisely the same forms of shady junk bond dealing that yielded similar high rates of profit and precipitated the current international finance crisis.

Should the Commerzbank and other ailing banks be unable to accomplish this Herculean task then they will go bankrupt, leaving the full costs of their debts with the German taxpayer.

A consolidation of German banks

As well as attempting to push impending bankruptcy for a number of private German banks beyond the planned election date in September (in what some commentaries have described as a "deep freeze" for toxic assets), Steinbrück is also intent on facilitating a consolidation of the German banking system, in particular its seven state-run banks (*Landesbanken*).

At the end of last month Steinbrück stressed that any plan to mop up toxic assets would be linked to a restructuring of the Landesbanken, a number of which rank amongst the biggest depositories of toxic assets. The LBBW is estimated to have junk bonds totalling €82 billion toxic assets, and the WestLB has an estimated €45 billion in its accounts.

According to financial analyst Konrad Becker from Merck Finck, the government's latest "bad bank" scheme could be the prelude to rationalising the country's state banks. "It does not make sense to have seven independent Landesbanks in Germany," Finck remarked. "The bad bank plan might be the catalyst."

Overseeing the reorganisation of the German banking system and the dismantling of the country's Landesbanken is the country's biggest private bank, Deutsche Bank and its CEO Josef Ackermann. Earlier this year Ackermann put forward his own proposal for one central "bad bank" based directly on government (i.e., taxpayer) funding. His proposal was not accepted by the government, which was concerned about a public backlash to such a scheme.

At the end of April Ackermann then declared that the government's scheme was the "right solution" for Germany—although his own bank would not make use of such a facility.

Ackermann and the Deutsche Bank board are keen to exploit the crisis to extend their own operations. Unlike many other German banks that recorded huge losses, Deutsche Bank was able to post profits for the first quarter of 2009—double the expectations of market analysts. Much of its increased turnover was bound up with the trading of government bonds freed up for the country's bank bailout policy and stimulus programs. It will undoubtedly seek to exploit the current round of bank rationalisations to extend its own empire.

In drawing up the details of its latest bad bank plan, the German government was forced to take into account the widespread hostility of the German population in an election year to further gifts to the banking world. In content, however, the plan worked out by Steinbrück is oriented entirely to the needs of Germany's major banks and finance houses.

The extent to which government policy is currently dictated by Germany's leading banks in consort with a small cabal of non-elected finance experts is a clear indication of the erosion of the democratic process in Germany.

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