US bank stress tests rigged to benefit Wall Street

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The release of the bank “stress tests” on Thursday has provided further confirmation that what drives the Obama administration’s economic policies is a determination to protect the wealth of the financial elite.

The government’s report states that while ten of the 19 biggest US banks, all of which have received taxpayer funds under the Troubled Asset Relief Program (TARP), require a combined $74.6 billion in additional capital to withstand a deeper recession, all of the banks are at present adequately capitalized and the financial system as a whole is sound.

It makes this assertion even while acknowledging that should the recession deepen significantly, the 19 banks could suffer $599.2 billion in losses over the next two years, and that their total loss rate for loans would be 9.1 percent, exceeding the levels of the 1930s.

Federal Reserve Chairman Ben Bernanke said in a statement, “The results released today should provide considerable comfort to investors and the public.” The only basis for such “comfort” is the assurance given by the Obama administration that it will not allow any of the banks to fail and will provide whatever public funds are necessary to keep them afloat.

The report lays out provisions for the “healthy” banks—such as JPMorgan Chase and Goldman Sachs—to pay back their TARP money so they can escape the minimal restrictions on executive pay and curbs on dividends and stock repurchases attached to the government handouts. This amounts to a blank check to fully resume the speculative practices that precipitated the crash in the first place.

Those banks deemed in need of additional capital—such as Bank of America, Citigroup and Wells Fargo—are offered access to Treasury funds or, if they choose, the opportunity to exchange preferred stock owned by the government for so-called “mandatory convertible preferred shares.”

This new type of preferred stock—which does not give the holder voting rights—would convert into common shares only if the bank posts losses in the future. As the *Wall Street Journal* pointed out Thursday, “That would allow the US to recapitalize the banks without controlling them. By keeping the investments as preferred stakes, at least for the time being, the government would remain a passive investor...”

The Obama administration has invented this device for the express purpose of boosting the balance sheets of the banks without giving the government any say in their operations.

When Treasury Secretary Timothy Geithner announced last February that as part of the Obama administration’s bank bailout program the government would carry out “stress tests” on the 19 biggest banks, a shudder went through the financial markets.

The stock market plunged and continued to fall through the early part of March. The administration presented the stress tests as a rigorous and objective measure of the financial strength of the nation’s largest banks, an exercise in “transparency” that would appease public anger over the transfer of hundreds of billions of dollars in taxpayer funds to the banks while ultimately reassuring investors worried over the state of the financial system.

Investors reacted, however, with near panic, and for good reason. They were not yet entirely sure of the intentions of the new administration, and they knew that a truly objective examination would reveal that many banks and financial institutions were insolvent. A serious examination of the banks’ balance sheets could only further discredit Wall Street and raise the question of taking the banks out of the hands of the private owners whose reckless profiteering had thrown the US and global economy into the deepest crisis since the Great Depression.

Indeed, the word “nationalization,” previously banned from public discourse in the citadel of free market capitalism, suddenly appeared in countless media commentaries, with the majority of economists and politicians warning against the dangers of any challenge, even if only temporary, to unfettered private control over the banks.

By mid-March, market sentiment began to turn, and it has been turning ever since. A two-month rally on Wall Street has seen share prices, led by financial stocks, rise by more than 20 percent. The market has soared even though most economic indices, above all the unemployment rate, have continued to point to a deepening slump, and the International Monetary Fund has reported that financial sector losses worldwide doubled over the past six months.

It is likely that the crisis of the US and world economy will produce new convulsions on financial markets. That, however, does not alter the fact that the most significant factor in the recent reversal of sentiment on Wall Street is the stream of reassurances from the Obama administration, public and private, that the American financial elite has nothing to fear from its policies.

When "nationalization" was being bandied about in the media—not as a socialist measure to place the financial system under the democratic control of the working class, but as a more effective way to bail out Wall Street—Obama and his top economic advisers issued repeated declarations of their support for capitalism and private ownership of the banks, and their opposition to any serious government intervention into the banks' operations.

The basic aim of the stress tests was, from the start, to present a picture that understates the critical state of the banks' finances in order to justify keeping them in private hands while facilitating the continued transfer of government funds to their coffers.

The entire exercise was devised to conceal more than it revealed.

In the first place, the government's "worst case scenario," which was the baseline for determining whether banks had sufficient capital, was unrealistically optimistic. The Treasury and the Federal Reserve Board assumed that, at the worst, unemployment would rise to 10.3 percent by the end of 2010. With the rate already at 8.5 percent, with jobs continuing to vanish at a pace of 600,000-plus a month, and with business investment continuing to decline, it is likely that the jobless rate will hit this level much earlier and exceed it.

The government, moreover, refused to estimate the value of the banks' toxic assets at their current market price, and instead inflated their worth.

It allowed the banks to provide their own estimates of their losses, based on the scenario presented by federal regulators.

At the insistence of the banks, it based its loss projections not on the banks' dismal 2008 earnings, as originally planned, but instead on the banks' earnings reports for the first quarter of 2009. Most of the big banks jigged up their first-quarter reports—already bolstered by government cash, virtually interest-free government loans and government guarantees on their debt—by means of deceptive accounting gimmicks in order to show healthy profits. They did this knowing that their reported results would skew the stress test results in their favor.

Finally, the government held intensive closed-door negotiations with the banks over the parameters and results of the tests prior to their public release. Federal Reserve and Treasury officials agreed to put off release of the test results from Monday to Thursday because, they said, some of the banks continued to disagree with the government's initial conclusions.

What is being obscured is the insolvency of much of the banking system and the fact that the government intends to expend trillions of dollars more in public funds to prop it up. The banks are hoarding billions in bad loans and securities, refusing to sell them at market prices or write them down, and the government is underwriting their actions by placing the Treasury at their disposal.

Other than concealing this reality from the public and propping up the financial markets, the stress tests are aimed at effecting a further consolidation of the banking system, in which the "healthy" banks absorb the rest, placing workers and small businesses more firmly in their vice.

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