CIT crisis threatens wave of business failures and layoffs

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The Obama administration has refused to provide government backing for outstanding debt or other emergency aid to CIT, a New York-based bank that finances nearly one million small and midsize companies in the US.

The collapse of CIT's efforts to secure government relief on Wednesday has left the 101-year-old bank teetering on the edge of bankruptcy and threatens a cut-off of funding to retailers and suppliers. That could result in a wave of bankruptcies and closures, leading to tens of thousands of layoffs.

The administration's decision to deny aid to CIT stands in sharp contrast to its policy of providing unlimited bailouts to major banks that cater to large corporations and big investors. It is of a piece with its decision to drive General Motors and Chrysler into bankruptcy in order to impose tens of thousands of layoffs and slash the wages and benefits of auto workers, its opposition to bailing out auto dealerships slated for closure, and its rejection of any federal aid to California or other states facing fiscal insolvency.

It is also in line with the administration's policy of allowing weaker and smaller financial institutions to fail in order to effect a further consolidation of the banking system in the hands of a few giant Wall Street firms.

CIT is the 26th largest bank in the US. Its bankruptcy would represent the fourth largest bank failure, by assets, in US history. As of Friday, the bank was seeking to stave off filing for Chapter 11 bankruptcy protection, a development that could rapidly lead to its liquidation.

It was reportedly in talks Friday with Goldman Sachs, JPMorgan Chase and Morgan Stanley on securing credit either to avert a bankruptcy filing, or secure sufficient financing to survive in bankruptcy court. The *New York Post* reported that JPMorgan, the biggest US bank, by assets, was interested in acquiring CIT's factoring unit, the bank's biggest and most lucrative business.

As the country's largest factor, CIT buys the receivables of thousands of manufacturers and suppliers, mainly to retail businesses. For a fee, it pays its clients cash up front, so they do not have to wait 30 to 90 days for retailers to pay for their supplies and inventory. It also guarantees suppliers that they will be paid even if retailers whom they supply go bankrupt.

CIT controls 60 percent of the US market for factors. It is a factor for some 2,000 manufacturers and suppliers whose goods are sold at 300,000 retailers across the country.

Both suppliers and retailers fear that a CIT bankruptcy will disrupt the flow of cash and credit, disrupting supply chains and leaving businesses unable to pay their bills.

Gail Dudack, chief investment strategist at Dudack Research Group, told clients, "The company's collapse would certainly ripple through thousands of small and medium business that rely on CIT for trade financing and lending. This raises the risk of more bankruptcies and more unemployment and would be a significant negative for an already fragile economy."

Roy Calcagne, CEO of Craftsmaster Furniture, said CIT's crisis could disrupt the entire supply chain of the furniture industry. "There could be a huge ripple effect that I'm not sure the government is fully aware of," he said, "especially if you look at all the ways this impacts supply chains. It could be devastating for our industry."

Jerry Reisman, a bankruptcy attorney at the law firm Reisman, Peirez and Reisman, told Reuters that he was "deluged" with desperate calls from apparel companies concerned about losing access to credit. "The government's decision will," he said, "result in many companies being unable to make payroll on Friday and inability to pay suppliers. Many of these companies and their suppliers will be forced to file bankruptcy themselves, causing a further decline in the economy."

CIT, which has an $80 billion balance sheet, has had eight straight quarters of losses, totaling $3 billion. Beginning in 2004, when its current CEO, Jeffrey Peek, took control, the bank plunged into subprime mortgages and student loans. The impact of the subprime collapse and resulting credit crunch has had a particularly crippling effect on CIT, which does not take deposits but rather relies on short-term commercial credit to finance its long-term debt.

For the past two years it has been cut off from wholesale credit markets. Last December, it obtained permission from the government to register as a bank holding company in order to receive $2.3 billion in cash under the Troubled Asset Relief Program (TARP).

CIT has $1.1 billion in debt coming due in August followed by $2.5 billion due by year's end. The Federal Reserve Board reportedly carried out a "stress test" on the bank earlier this week and concluded it needed at least $4 billion in capital to stay afloat.

Its speculation-driven problems are not essentially different from those of giant banks and financial firms such as Goldman Sachs, JPMorgan Chase, Citigroup, Bank of America and American International Group which have received tens of billions in taxpayer handouts and are deemed by the Obama administration "too big to fail."

An administration spokesman said the decision to deny CIT emergency support demonstrated that Obama has "a very high standard" as to which firms can receive government assistance. More to the point, it demonstrates the degree to which the administration's economic policies are dictated by the biggest Wall Street players.

Since the financial crisis erupted last year, the government has engineered the disappearance of Bear Stearns, Lehman Brothers, Merrill Lynch, Wachovia and Washington Mutual, immensely increasing the economic power of the strongest mega-banks, particularly Goldman Sachs and JPMorgan Chase.

There are a host of smaller regional banks that are sliding toward bankruptcy, further increasing the dominance of the biggest Wall Street firms. At a Senate Banking Committee hearing on Thursday, Senator Jim Bunning, Republican from Kentucky, said Federal Deposit Insurance Corporation Chairman Sheila Bair had told him another 500 banks could fail "unless something dramatic happens."

The decision to deny aid to CIT came amidst spectacular second-quarter earnings reports by Goldman Sachs and JPMorgan Chase. Goldman reported record earnings of $3.44 billion and JPMorgan reported a sharp rise in profits to $2.7 billion for the quarter. Both banks reaped the vast bulk of their profits from their investment banking and trading divisions.

They are benefiting from the demise of competitors and the ongoing troubles at Bank of America and Citigroup, which gives them greater access to fees generated by underwriting stocks and bonds, while they take advantage of market volatility to place their own bets on stock and bond price fluctuations. Neither these, nor other major banks, are using the lifeline provided by government cash and other subsidies to significantly increase lending to businesses or consumers.

They continue to hide an estimated $2 trillion in toxic assets on their balance sheets, refusing to sell the nearly worthless assets at market prices or write down their value. JPMorgan, even as it reported higher profits, noted large losses in consumer loans and commercial real estate. Citigroup and Bank of America, in their earnings reports released on Friday, similarly reported growing losses in these sectors. These assets will continue to deteriorate as the impact of mass unemployment leads to more defaults on consumer loans and prime mortgages, and the recession further depresses commercial real estate values.

Goldman set aside nearly half of its quarterly revenues of $13.8 billion for salaries and bonuses, setting the stage for record compensation packages for executives and senior employees. This is in line with a general resumption by the banks of seven-and-eight-digit windfalls for top executives.

White House Chief of Staff Rahm Emanuel implicitly alluded to the bumper earnings reports by Goldman and JPMorgan in justifying the decision to cut off CIT. "Given the sense of calm," he said, "it is a symbol of a different phase" in the government's rescue of the banking system.

Similarly, Obama's top economic adviser Lawrence Summers in a speech in Washington DC declared that the US financial system was "back from the abyss," and Treasury Secretary Timothy Geithner said the financial markets were sending "important signs of recovery."