Timothy Geithner’s *Stress Test*: Confessions of a Wall Street bag-man

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Stress Test: Reflections on Financial Crises (Crown Publishing Group, 2014, 592 pp.)

Stress Test, the memoir published last month by former US Treasury Secretary Timothy Geithner, documents the conspiracy to prepare and execute the 2008 bank bailout, from the point of view of the operation’s leading architect.

Geithner’s main goal in writing the book is to present his actions as president of the New York Federal Reserve and later as treasury secretary as justified and necessary. But these attempts are largely half-hearted, intended to convince people who want to be convinced.

The book is of interest not for Geithner’s self-justifications, but because it presents a detailed overview (at nearly 600 pages) of the bank bailout and includes significant new information about how the Bush and Obama administrations decided upon the course of action they took in 2008 and 2009.

In his memoir, Geithner concedes that the average American thinks the bank bailout was aimed at protecting Wall Street interests at the expense of the population. As he puts it, “We did save the economy, but we lost the country doing it.” Geithner adds, “Conventional wisdom still holds that we abandoned Main Street to protect Wall Street.”

In this case, “conventional wisdom” is correct.

The 2008 financial meltdown was precipitated by frenzied Wall Street speculation fueled by a real estate and credit bubble that swelled bank profits, executive pay and the wealth of the super-rich to the highest levels in US history. The speculation, which utilized highly complex financial instruments, was facilitated by government regulators. They not only turned a blind eye, they actively encouraged Wall Street’s “financial innovation” while providing plenty of cash, via the Federal Reserve’s low interest rate policy.

When home values began to decline, the entire financial system became insolvent and the government bailed out every major bank with taxpayer money in the face of widespread popular opposition. According to Geithner, the government loaned nearly $7 trillion to the financial system, which was used to prop up over $30 trillion in financial assets—more than twice the yearly output of the United States.

These actions halted the collapse of financial asset values and led to the creation of another asset bubble. Since 2009, both the Dow Jones Industrial Average and the wealth of the super-rich have more than doubled, while the income of a typical US household has fallen by more than $5,000. The bank bailout was followed by more then $2 trillion in budget cuts and the layoff of more than half a million government employees.

Geithner’s memoir documents his emergence as the leading spokesman for the banks and financial interests within the Federal Reserve and the Obama administration. In every major policy debate, he directly took the side of the banks, to the point where even White House economic adviser and former Treasury Secretary Lawrence Summers—one of the figures most closely associated with financial deregulation—accused him of being “too cozy” with banking interests.

Throughout the 2008 crash and subsequent bailouts, Geithner served as a political whip and enforcer, a backstage operator working to maximise the bankers’ profits, cover their failed investments, and shield them from prosecution and accountability for their crimes.

The book, and indeed Geithner’s whole career, is a testament to the corruption of the American political system: its leading figures’ contempt for democracy and the popular will, their hatred of equality, and the dishonesty that pervades every press conference and congressional hearing. The real decisions are made in the background. What is presented to the public are “fig leaves” and “irrelevant shiny objects,” as Geithner calls the meaningless executive pay limits included in so-called Troubled Asset Relief Program.

Geithner was born in 1961 in Brooklyn, New York and grew up in Zimbabwe, Zambia, India and Thailand, where his father served as a leading figure in the Ford Foundation, an international development organization with close ties to the CIA . Geithner’s life and career in significant ways parallel those of his future boss, Barack Obama.

They are both American citizens who grew up abroad and whose parents worked for international development groups tied to the American intelligence apparatus. Geithner notes that at one of their early meetings, he and Obama “discussed an odd family coincidence: When my father was running the Ford Foundation’s Asia programs, the foundation had funded the work of Senator Obama’s late mother, Ann Dunham, while she built a microfinance program in Indonesia.”

During his freshman year at Dartmouth College, Geithner spent Christmas break as a war photographer for the Associated Press during a conflict along the Thai-Cambodian border, despite the fact that he had “little interest in politics, economics, or even current events.” His career was a fast-track progression up the Washington ladder.

Geithner recounts that while attending the School of Advanced International Studies at Johns Hopkins University (whose faculty includes leading figures in the US military/intelligence establishment), a professor asked him “which economics journals I read. I replied that I had never read any. Seriously? Yes, seriously. The professor seemed incredulous. He decided my clear lack of interest in economics disqualified me from an honors grade.”

After graduating, he went on to work for three years at Kissinger Associates, a foreign policy consulting firm run by former Secretary of State Henry Kissinger and former National Security Adviser Brent Scowcroft. He was employed as “something of an Asia specialist.” Geithner does not report his pay, but, as he puts it, “Kissinger Associates seemed like an interesting place to start paying off my student loans.”

He moved on to work at the International Affairs Division of the US Treasury Department in 1988, and then served as an attaché at the US embassy in Tokyo. He returned to Treasury to serve as undersecretary for international affairs under treasury secretaries Robert Rubin and Lawrence Summers, both of whom he cites as mentors. After working as an official

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at the International Monetary Fund in 2001, Geithner was, at the insistence of Summers and Rubin, appointed to head the Federal Reserve Bank of New York, the second most powerful position within the Federal Reserve, behind only the Fed chairman.

From this brief description it is clear that Geithner was groomed for a state career by powerful figures, including Summers and Rubin.

Geithner's rapid advancement is explained not by merit, but by his absolute and unconditional devotion to the promotion of Wall Street's interests, to the point where it made even notorious free market ideologues uneasy. Geithner recalls in his book the struggle waged by Summers and then-Federal Reserve Chairman Alan Greenspan to prevent the regulation of financial derivatives, proposed in the late 1990s by then-Chair of the Commodity Futures Trading Commission Brooksley Born.

"During one discussion in Rubin's small conference room, I invoked the lazy argument that regulating the over-the-counter market might drive derivatives offshore. I must have sounded like a bank lobbyist, and Rubin shot me a derisive look," recalls Geithner.

Instead of regulating derivatives, Geithner worked to expand, systematize and computerize their use. This was the goal of a 2005 meeting with the leading dealers of derivatives, to whom he refers in the book as "the Fourteen Families," because it was "as if they were warring Mafia bosses meeting in a back room to discuss their common interests."

As a result of his work with the "Fourteen Families," Geithner boasts, "the backlog of unconfirmed credit derivatives had been reduced by 92 percent, even though the volume had tripled. Electronic processing of equity derivatives had increased from 34 percent to 94 percent."

The mob boss imagery is entirely appropriate, with Geithner playing the role of consigliere.

The deregulation of the financial industry, in which Geithner, Rubin and Summers played a leading role, allowed the banks, with the knowledge of regulators, to offload semi-worthless subprime home loans onto global investors by packaging them into mortgage-backed securities and collateralized debt obligations. This gigantic Ponzi scheme turned the market for home loans into a racket. It could continue to generate huge profits only as long as home prices continued to rise.

But more and more people were buying homes with loans they could not afford. When home prices began to decline, the entire financial edifice collapsed, triggering the 2008 crash.

Once the crisis erupted, Geithner took the tack that it "was not the time to focus on punishing the arsonists. It was the time to focus on putting out the fire."

There was, as he put it, "intense pressure on us to punish the Wall Street gamblers who had gotten us into this mess—to nationalize or liquidate floundering firms, or force bondholders to accept 'haircuts' rather than the face value of their bonds."

Geithner relentlessly fought against such positions, and Obama took Geithner's side in every case.

Throughout the book, Geithner seeks to present himself as an impartial technocrat and pragmatist, taking the steps necessary to save the financial system with no regard to "politics." He claims that the course of action he took was the only way to prevent a new depression. In fact, Geithner had a well worked-out and consistent line on how to handle the bank bailout, from which he and the Obama administration did not depart.

*** There would be no "haircuts" for bank creditors: debts of bailed-out companies would be paid in full at taxpayer expense.**

This was most notable in the bailout of the credit insurer American International Group (AIG), where the insurer's debts were paid one hundred cents on the dollar, with Goldman Sachs being the largest beneficiary of a $200 billion handout from the government.

*** There would be no meaningful restrictions on executive pay.**

At Geithner's insistence, the White House allowed $165 million in bonuses to be paid to employees at AIG's Financial Products unit only a week after the company received an additional $30 billion in bailout funds. "Let me get this straight," Geithner recalls Obama saying. "We're going to pay bonuses to the very people who caused all this damage to the financial system?" "Yeah, basically," replied Geithner.

And that was that. The Obama administration made sure that a bill to tax the AIG bonuses at 90 percent which passed in the House of Representatives did not make it to the Senate.

*** Bailed-out companies would not be nationalized.**

At Geithner's insistence, the White House had financial regulators "sign in blood," as he put it, a statement that "The strong presumption… is that banks should remain in private hands."

*** CEOs at bailed-out banks would not be replaced, much less prosecuted.**

Geithner was adamant that the financial institutions that received government capital retain the leaderships that ran the firms into the ground. Prosecuting executives was likewise out of the question. Geithner writes that, "the financial activities most responsible for the crisis weren't illegal, however unethical or dumb they may have been."

Amazingly, the memoir of a "lifelong financial regulator" uses the word "illegal" only three times, and never in connection with an accusation of criminal activity.

*** There would be no substantive assistance to borrowers.**

Geithner fought against forcing banks to reduce loan principals for mortgage borrowers falling behind on their payments. Instead, the Obama administration's housing assistance program merely had banks voluntarily lower borrowers' monthly payments. As a result, the homeowners assistance program was an empty shell.

So adamant was Geithner in upholding these principles that he clashed with other dedicated defenders of Wall Street in Obama's economic team, including his mentor, Lawrence Summers, who wanted to impose "haircuts" on the creditors of bailed-out firms, carry out some nationalizations, and replace executives.

Geithner declares that he did not share Summers's view that "we could fashion a crisis response that was both effective and politically popular." He notes that in the administration's "internal strategy discussions, some participants—at times including Larry [Summers]… suggested that widespread nationalization was inevitable and even necessary. Nationalization was a threatening word for investors in a market economy, implying that shareholders could be wiped out, creditors could be haircut, and politicians could be taking control of private firms."

Geithner complains that, "Behind closed doors, even Larry suggested the fix was in, complaining that the Fed was too cozy with banks."

Obama passed over Summers for the position of Federal Reserve chairman when Ben Bernanke stepped down last year, nominating Janet Yellen instead.

Obama's decision to appoint Geithner as treasury secretary in 2009 was "an endorsement of all the unpopular stuff" he and then-Treasury Secretary Henry Paulson had done, as he puts it. "I was another Mr. Bailout," he writes.

Obama showed the depth of his commitment to "Mr. Bailout" when he decided to go through with Geithner's nomination despite the fact that the vetting process found that the soon-to-be head of Treasury (and the Internal Revenue Service) had cheated on his taxes. Geithner was confirmed by the Senate by the narrowest margin of any treasury secretary since World War II.

The book also sheds light on the demise of Lehman Brothers, which Treasury and the Fed allowed to collapse for reasons that have never been coherently explained in official accounts. Geithner presents at least three reasons for letting Lehman collapse: that the White House would not allow the Federal Reserve to bail out Lehman, that British regulators stopped a buyout deal that would have averted bankruptcy, and that Lehman was in a fundamentally worse position than either Bear Stearns,

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which was purchased by JPMorgan Chase in March, 2008 with a $30 billion government subsidy, or AIG, which was bailed out the day after Lehman collapsed.

Geithner concedes that the public does not believe these explanations. “The world still believes we made a conscious choice to let Lehman go. That’s the standard journalistic account, shared by many economists and financial players.”

He then proceeds to suggest, in a backhanded fashion, that Lehman’s demise created the political climate for the ensuing bailout of the whole financial system.

He writes: “Even in a world where we somehow rescued Lehman, and then still went ahead and rescued AIG, we would not have eliminated the fundamental factors driving the crisis. The economy was collapsing, and the financial system would have kept lurching toward disaster—undercapitalized, overleveraged, still burdened by mortgage assets the markets wouldn’t touch, still under threat of a broader run. It took the fall of Lehman and the impending collapse of AIG to persuade President Bush and Hank [Paulson] to seek legislative authority to try to repair the entire system.”

Geithner here comes close to admitting that he and Fed Chairman Bernanke decided to throw Lehman to the wolves in order to create a sufficiently intense atmosphere of crisis to obtain the legislation from Congress that would be needed to use taxpayer money to prevent the collapse of every other major US financial institution.

Lehman’s collapse led within four days to the proposal for the $700 billion Troubled Asset Relief Program, which was passed by Congress on October 3, 2008. Geithner notes that following the Lehman collapse, Barney Frank, the Democratic chairman of the House Financial Services Committee, remarked that “the terror of the free fall could dampen enthusiasm for government inaction, and shock the political world into taking the crisis seriously. ‘Maybe this will shut up the crazies,’ he said.”

Having facilitated the activities that led to the financial crisis, bailed out the banks, and shielded their executives from prosecution, Geithner concludes that he is “proud of what I did in public life, but I couldn’t do it forever.” He accordingly chose to “learn a new craft in the investment world” by becoming the head of the buyout firm Warburg Pincus, where he will presumably make millions.

Geithner emerges from his own account as a despicable figure, a financial mafia bureaucrat, perhaps with state intelligence connections. If there is one unifying thread in his career, it is contempt for the people. He captures something essential about the American ruling class, which thinks any crime can be covered up with a big enough lie.

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