The art of snatching defeat out of victory - Part II

Daily Kos
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July 23, 2009

This is the second part of my 7-part series on the economy, health care and budgetary restrictions of the Obama agenda.

3. Toxic assets
The Public-Private Investment Partnership announced in March had a substantial problem since its inception: They could not force the banks to sell the troubled assets that were prolonging the uncertainty linked to the crisis. The longer the crisis, the more pervasive its effect on the price of those toxic assets and the greater the likelihood that those assets lose even more value for the moment in which the financial institutions that pose the bigger systemic risk end up selling them, if they are not intervened first. The greater also is that those assets end up affecting negatively other economic agents as the owners of those troubled assets could engage in transactions that end up bringing down other economic agents. Let's remember that mark-to-market rules have not been able to adjust the value of those assets, which have turned into extremely illiquid, so making possible that these assets can claim new victims among those who see them in the balance sheet of their owners. As the economic agents cannot be sure of identifying them –they don't have a sign saying 'troubled asset'-, the value of other healthy buy iliquid assets can also be affected by these widespread negative expectations.

Does it make sense the design of the Public-Private Investment Partnership? Geithner has defended it saying that it will share the risk of those assets between private and public capitals. If we consider that the program could involve up to a trillion dollars and that the FDIC will cover up to 85% of the cost of the assets with non-recourse loans (what means that if the asset value sinks, the FDIC will have nothing else to take but what it can get from selling the asset, what can generate a loss if the value of the asset deteriorates even more or the asset is bought above its real maket value), the partnership would have made much more sense if Obama had inherited the fiscal superavit Bush inherited from Clinton and the financial institutions resisting a troubled assets would have had the obligation of increasing the shareholder's capital accordingly to the risk represented by that asset in the balance sheet of the institution. The Treasury has declared that some banks' resistance to sell their troubled assets to the PPIP has been the result of they raising capital instead but the Treasury has no way of making the most affected troubled institutions realize their losses before it is too late, when the FDIC has no other option that taking them over. Thus institutions that pose the biggest risk of socializing losses not only can continue making risky decisions knowing they have little to lose but also continue affecting other economic agents.

As Harvard Law School professor Lucian Bebchuk has noticed (http://blogs.wsj.com/...), "a month after the PPIP program was announced, under pressure from banks and Congress, the U.S. Financial Accounting Standards Board watered down accounting rules and made it easier for banks not to mark down the value of toxic assets. For many toxic assets whose fundamental value fell below face value, banks may avoid recognizing the loss as long as they don't sell the assets.

Even if banks can avoid recognizing economic losses on many toxic assets, it remained possible that bank regulators will take such losses into account (as they should) in assessing whether banks are adequately capitalized. In another blow to banks' potential willingness to sell toxic assets, however, bank supervisors conducting stress tests decided to avoid assessing banks' economic losses on toxic assets that mature after 2010."

With a very limited capacity of engaging in additional indebtedness, Obama risks having to sacrifice his own agenda or generating a crowding out effect, not to mention the systemic risk that could still result of financial institutions reluctant to realize losses now by deferring selling their toxic assets. The savings defended by Geithner are not worth the pain to take this risk, increased by the uncertainty, increased by the already mentioned prolonged resistance of the troubled institutions to sell their toxic assets.

On June 29 Ben Levisohn (http://www.businessweek.com/...) reported that the Bank of International Settlement released a report saying that toxic assets still threaten the financial system, the risk of contagion to other assets and a sustained recovery.

4. A second stimulus?
Could a bolder action in this front save us from needing a second stimulus? Warren Buffett (http://abcnews.go.com/...) was very critic of the first stimulus package:

"Our first stimulus bill ... was sort of like taking half a tablet of Viagra and having also a bunch of candy mixed in ... as if everybody was putting in enough for their own constituents."

The expansion of the tax credit for first time homebuyers and other tax cuts were an unavoidable concession to the three moderate Republicans that helped avoid a filibuster but, considering the profound uncertainty characteristic of this recession, were a waste of resources. On the other hand, many funds given to states were wasted in debatable projects. Nevertheless, the short term-long term mix of the package was positive despite the overoptimistic announcements. On the other hand, a second stimulus package, even one focused almost exclusively in food stamps, unemployment benefits and short term infrastructure projects, may risk creating a crowding out/inflationary effect, negatively affecting the private sector, or postponing the rest of the Obama agenda. Before distracting the already overcharged debate and investing more political capital in a second stimulus, what we need is to put teeth in the PPIP to help the economy realize its losses as soon as possible. Anyway, beyond the Republican cry, it is still premature to evaluate the effects of the first stimulus package.

Finally, fiscal restrictions put in a very difficult situation the need of overhaul our infrastructure. From one end to the other, I heard a well informed engineer saying that up to 50% of the electricity transmitted through our electric grid could get lost. Last year the American Society of Civil Engineers downgraded our infrastructure again and proposed the need of spending $2.2 trillion in infrastructure during the next five years." (http://pubs.asce.org/...). While Obama has rightly committed to improve our education system –actually, we could begin changing the real property-tax based anachronism that makes of inner city schools, poor schools, places where the poor are taught to be poor, infrastructure has not received the same attention beyond some

projects in the stimulus package and even these projects have sometimes be affected by counterproductive decisions made by the states recipient of stimulus money. Here we must be very open-minded. Some time ago I watched a debate between a member of the Cato Institute (Please, don't confuse with pseudo-think tank and tales-factory, the Heritage Foundation) and a member of a progressive think tank about private participation in the economy. Of course, the member of Cato was for privatization. His opponent then began mentioning cases in which private participation had been tainted by the effects of crony capitalism. Consider, in example, the obscure relationship between Halliburton and the Army Corps of Engineers; consider the work of contractors in Iraq like Parsons, Blackwater, Caci or Custer Battles. It's here where we need to evaluate the socioeconomic impact of every infrastructure project and consider partnerships with private capitals or private projects self-financed by fees or tolls. In this case, we need a solid regulatory framework and an even more solid supervision to avoid situations that have become unfortunately so familiar. Not every private company is Halliburton as not every government-owned agency or company is inefficient. Consider Codelco, the widely acknowledged efficient Chilean company who exploits and trade the Chilean copper, which represents about half of the exports of that very dynamic country. Consider FEMA, the efficient federal agency that became a joke during the administration of George W. Bush. If we are not willing to drop easy labels and grow up, we may have to consider that countries like China may not be willing to wait for us. If something has the American military industrial complex has taught us is that spreading their interests across states has been very useful for it to submit Congressmen and Senators to pass funding of Presidential helicopters or $1.75 billion F-22 planes, even if Obama doesn't want them. Maybe the best way en overcoming this situation is replacing these special groups linked to wasteful spending with another one, at least linked to the necessary overhaul of our infrastructure. Widespread infrastructure projects creating jobs and competing for governmental funding in the hands of private or mixed companies could be a way of limiting the influence of these military industrial companies. It's not the ideal situation but at least much better than the present status quo. Obviously, I don't think the best moment to make something like this happen will come before the beginning of a second Obama administration. China is not waiting for us. This could sound shocking but, at least while we get proper finance campaign reform and get rid not only of Buckley v. Valeo but also of that legal way of bribing called 'campaign contributions', of the revolving doors between government and lobby positions and of Swift Boats and other surrogates, I don't see other way.

On June 17 The Hill published a special report on transportation and infrastructure. In there I found Rep. Oberstar's article, which says that "regrettably, our transportation system, once the envy of the world, is losing its battle against time, growth, weather and wear. The system is suffering from decades of underinvestment, and the costs are staggering"; "the nation's largest public transit agencies face $80 billion maintenance backlog to bring their rail systems to a state of good repair"; "since 1995, the percentage increase in miles traveled on the national highway system has been three times the percentage growth in the system's capacity"; "unlike citizens of other major industrialized nations, Americans have limited transportation choices"; "since completion of the Interstate highway system, our national transportation policy has lacked strategic focus"; "in addition, federal transportation programs have no performance metrics"; "throughout federal surface transportation programs there is limited transparency, accountability or oversight. There are also unnecessarily long delays –more than 10 years for many highway and transit projects- for needed transportation improvements to be planned, approved and

constructed. Lastly, the financing mechanism for the programs is in crisis. The Highway Trust Fund does not have adequate revenues to meet existing commitments made by the federal government"; "the Federal Aid Highway Act of 1956 (P.L. 84-627) (...) established formula grant programs to distribute federal surface transportation fund to states" and "today, there are more than 108 individual programs, as well as dozens of set-asides and takedowns, that provide federal surface transportation funding. Overlapping and similar eligibility, transferability of funds, and the lack of transparency, accountability, and oversight make it impossible to determine whether programs are meeting national objectives." (http://thehill.com/transportation-report-a-blueprint-for-investment-and-reform.html). In that report, you can also find an article by Senator Patty Murray, who warns us about the "impending bankruptcy of the Highway Trust Fund", who also says "If we don’t step up to the plate and provide the Trust Fund with an estimated $5 billion to $7 billion before August of this year, transportation projects across the country may screech to a halt, state budgets will be thrown into crisis, and thousands upon thousands of family-wage jobs will be put in jeopardy" (http://thehill.com/...).