



Banks' 'Catatonic Fear' Means Consumers Don't Get TARP Relief

[Email](#) | [Print](#) | [A A A](#)

By James Sterngold

Jan. 5 (Bloomberg) -- As the new owner of \$172.5 billion of preferred shares and warrants in 208 U.S. financial institutions, the Treasury Department hasn't succeeded in thawing frozen credit markets, leaving taxpayers propping up an industry that won't lend to them.

While inter-bank lending rates have fallen since Congress approved the \$700 billion Troubled Asset Relief Program on Oct. 3, most bank lending to consumers remains tight and interest rates high. The average credit-card rate was 14.33 percent on Dec. 16, according to IndexCreditCards.com in Cleveland, almost unchanged from 14.41 percent in October 2007.

That's prompted criticism from **Alan S. Blinder**, a professor of economics at Princeton University in New Jersey and a former Federal Reserve vice chairman, who says the government should take a more active role as a stakeholder in the nation's banks.

"With the banks in a state of catatonic fear now, they're just sitting on the capital," Blinder said in an interview. "I don't fault the banks one bit, since this shows Wall Street they're safer, but then this doesn't get you much improvement. If you're taking money from the public purse, we should get something in return, and we're really not."

Jeffrey Garten, a professor of international trade and finance at the Yale School of Management in New Haven, Connecticut, and a Commerce Department undersecretary during the Clinton administration, says banks should be forced to increase their lending or risk having taxpayer money taken away.

"The government isn't acting aggressively enough to demand a quid pro quo," Garten said. "The public good is the key to the private good in this case. It's not the other way around."

\$8.5 Trillion

Although the government has committed more than \$8.5 trillion to energizing the economy, and the Fed cut a key **lending rate** almost to zero, banks haven't made it easier to borrow. The Fed said consumer credit fell by \$6.4 billion in August, the largest drop in 65 years, and then by \$3.5 billion in October, the first time since 1992 that there were two months of declines in a year.

In its most recent quarterly Senior Loan Officer Opinion Survey in October, the Fed reported that about 85 percent of U.S. banks said they had tightened standards on commercial and industrial loans to companies with more than \$50 million in annual sales, up from 60 percent in July. Ninety-five percent said they increased the cost of those loans. About 70 percent said they made it more difficult to obtain prime mortgages, and almost 65 percent said they did the same for consumer loans.

Mortgage Rates

While mortgage rates have declined, they haven't fallen as fast as bank borrowing rates, meaning financial institutions are demanding more profit for every dollar they lend. Average rates on 30-year residential mortgages fell to 5.14 percent last month, according to data compiled by McLean, Virginia-based **Freddie Mac**. That's down from 6.67 percent in June 2007, before the worst turmoil in the

housing market. At the same time, the **spread** of mortgage rates over the 10-year Treasury bond yield rose to 2.958 percentage points from 1.567.

The spread of rates on so-called jumbo mortgages, those of more than \$729,750, is close to a record at 1.6 percentage points above the rate for smaller mortgages that conform to terms of ones Freddie Mac and Fannie Mae will purchase, according to financial data firm **BanxQuote** in White Plains, New York. A year ago the difference was 0.23 percentage points.

High interest rates have angered consumers. The Fed has offered relief in the form of rule changes that allow banks to raise rates only on new credit cards and future purchases, not on existing balances. Banks will also have to give cardholders 45 days notice of changes in terms, up from 15 days. Those changes aren't scheduled to take effect until July 2010.

'We Own Them'

"We own them now, and we should use that to make sure they stop ripping us off," said **Gail Hillebrand**, head of the financial-services campaign at Consumers Union, an advocacy group based in Yonkers, New York. "We shouldn't allow banks to use the money to support things that hurt consumers and taxpayers. What we're looking for is responsible behavior, not social benefits."

Bank profits or returns on the government investments are secondary concerns, Hillebrand said.

That view is opposed by free-market advocates such as **Gary Becker**, a professor of economics and sociology at the University of Chicago and a Nobel Prize winner, who says the primary aim of the government bailout should be a hasty withdrawal from investments that shouldn't have been made in the first place.

"If you believe in a private-enterprise system, you use competition to control the banks, not a stakeholding," Becker said. "It would be a grave mistake to use these private institutions for social goals."

Paulson Changes Course

Diane Casey-Landry, chief operating officer of the American Bankers Association, a trade group in Washington, said that bank profitability had to come ahead of any demand to ease lending.

"Taxpayers should get a return on their investment," Casey-Landry said. "We have to go back to a time when we realize not everyone is entitled to get a loan. What is going to get us out of this recession is sound lending to people who are going to pay it back, not throwing money at people who can't."

When Congress passed the Emergency Economic Stabilization Act in October authorizing TARP, the funds were supposed to be used to acquire troubled mortgage-related assets from banks in order to ease credit.

"The underlying weakness in our financial system today is the illiquid mortgage assets that have lost value as the housing correction has proceeded," Treasury Secretary **Henry Paulson** said on Sept. 19. "These illiquid assets are choking off the flow of credit that is so vitally important to our economy. When the financial system works as it should, money and capital flow to and from households and businesses to pay for home loans, school loans and investments that create jobs."

TARP Allocations

Two weeks after the legislation was passed, Paulson changed course and said it was more important to recapitalize the banks, allowing them to determine how best to deploy their capital.

Since then, Treasury has allocated \$250 billion to buy non-voting preferred shares of banks paying a 5 percent annual dividend, as well as warrants convertible into equity. The investments range from \$25 billion each in **JPMorgan Chase & Co.**, **Citigroup Inc.** and Wells Fargo & Co. in San Francisco to \$1.6 million in Westminster, California-based **Saigon National Bank**.

In addition, \$40 billion has gone to New York-based **American International Group Inc.**; another \$20 billion to Citigroup in New York, along with a \$5 billion guarantee against possible losses; \$20 billion to

purchase consumer and small-business loans; and \$13.4 billion to Detroit-based automakers General Motors Corp. and Chrysler LLC.

'No New Lending'

Last week the government announced that \$5 billion of TARP funds would be used to purchase preferred shares and warrants in **GMAC LLC**, the automaker's financing arm, with Treasury separately lending another \$1 billion to GM to support GMAC's transition into a bank holding company.

With the exception of GMAC, which immediately began offering loans to GM customers with lower credit scores in order to halt the decline in auto sales, most financial institutions that received TARP funds have been reluctant to lend.

"Right now there is no new lending, and without new lending it's going to be difficult for the economy to recover," **Roger Altman**, founder and chief executive officer of boutique investment bank Evercore Partners Inc. and an assistant Treasury secretary in the Carter administration, said in a Dec. 29 interview with Bloomberg TV.

Stifling Innovation

A report released Dec. 2 by the Government Accountability Office in Washington questioned whether Treasury is policing the cascade of federal money closely enough.

"Although Treasury has said that it expects the institutions to increase the flow of credit," the report said the department "has not yet determined whether it will impose reporting requirements on the participating financial institutions."

David John, a senior fellow with the Heritage Foundation, a public policy and research group in Washington, said it was inappropriate for the government to demand policy changes from the banks and that doing so would be counterproductive because it would stifle innovation. Instead, he said banks should use the capital to recover stability and then be forced to return the taxpayer funds.

"Bureaucrats take no risks, they have no ideas," John said. "If this recoups a profit for the taxpayer, great, but a slight loss would be acceptable. I don't see it as a long-term value to be an activist shareholder."

'No Road Map'

There are no partisan lines separating those who favor a passive investment strategy and those who want the government to play a more active role.

"I do not see the Treasury or the Fed as active investors in the banks, and it would be a mistake if they were," said **Martin N. Baily**, a chairman of the Council of Economic Advisers in the Clinton administration and now a senior fellow at the Washington-based Brookings Institution. "The goal is to stabilize the financial sector and to be mindful of the costs to taxpayers. Perhaps there will be positive returns on these investments, but not necessarily."

Bruce Josten, executive vice president for governmental affairs at the U.S. Chamber of Commerce, a pro-business group, said taxpayers had a right to expect a loosening of credit by the banks, though the government "shouldn't micromanage them."

"I don't think there's one good answer here," Josten said. "There's no paint-by-the-numbers road map. It's all improvised."

For Garten, the unprecedented nature and scale of the problems means that policy makers and taxpayers will have to get used to a new way of thinking as long as the crisis lasts.

"There's a philosophical conflict in the American mind because we're just not used to this level of intervention," Garten said. "That hang-up is not compatible with the depth of this crisis."

To contact the reporter on this story: **James Sterngold** in Los Angeles at jsterngold2@bloomberg.net

Last Updated: January 5, 2009 00:01 EST



©2009 BLOOMBERG L.P. ALL RIGHTS RESERVED. [Terms of Service](#) | [Privacy Policy](#) | [Trademarks](#)