

# Banking Presentation

# What is a Bank?

- The role of government is to provide public infrastructure for further public purpose

# What is a Bank? (cont)

- The national payments system is an element of public infrastructure.
- Banking functions to provide access to the payments system.
- Checking accounts, wire transfers, check cashing?
- Savings accounts?

# What is a Bank? (cont)

- The liability side of banking is not the place for market discipline
- Public purpose is served by FDIC insurance for bank accounts.

# What is a Bank? (cont)

- Should banks engage in lending?
- What can a bank do that serves public purpose that private lenders can't do?

# What is a Bank? (cont)

- Lending based on credit analysis rather than market value requires govt. insured liabilities
- Private firms fund themselves based on the market value of their loans
- Therefore banks can lend on credit analysis
- Does this serve public purpose?
- Business loans, home loans, car loans?

# What is a Bank? (cont)

- Should banks be publicly owned or privately owned?
- The difference is whether risk is priced by the public sector or the private sector.
- The public purpose of capital ratios is to have a tool to alter the pricing of risk.
- Protecting tax payer money is a secondary function.

# What is a Bank? (cont)

- There is no public purpose served by allowing banks to sell their loans.
- There is no public purpose in selling credit default risk when loans are based on credit analysis
- There is no public purpose for banks engaging in any secondary market activity.
- There is no public purpose to proprietary trading.



# What is a Bank? (cont)

- There is no public purpose in engaging in any secondary market activity.
- The argument 'it didn't cause the crisis so why should we prohibit it' makes no sense.
- The argument that an activity should be permitted solely because it would be profitable and protect taxpayer money makes no sense.

# What is a Bank? (cont)

- Banking should be a lot more limited than even restoring Glass-Steagall implies.

# What is a Bank? (cont.)

- The number of regulators needed increases geometrically with expanded bank activities.

# Understanding TARP

## Assumptions:

- 10% required Capital Ratio
- A bank with \$100 billion in private capital loses half of it.
- Only \$50 billion in capital remains.
- The Government does not want to shut it down

# Understanding TARP (cont.)

- Treasury Secretary Paulson recommends the US Treasury purchase/inject \$50 billion of capital into the troubled bank.
- Obama flies in to rally the Democrats
- McCain flies in to rally the Republicans
- The DOW moves 1000 points a day
- President Bush says we are doomed if it doesn't pass
- Millions of jobs are lost

# Understanding TARP (cont.)

- The bill is passed!
- The Treasury buys \$50 billion of capital in the troubled bank
- Terms and conditions are imposed
- The bank again has \$100 billion of capital (10% of assets)
- The world is saved!

# Understanding TARP (cont.)

But what has actually changed?

- Before TARP the bank had \$50 billion of capital left after taking its losses
- The FDIC wanted to shut it down because after it lost the next \$50 billion, the FDIC would have to write the check to cover additional losses.

# Understanding TARP (cont.)

After TARP:

- The bank still has only \$50 billion in private capital to cover additional losses.
- The Treasury has to write the check for the next \$50 billion in losses.



# Understanding TARP (cont.)

- What's the difference between the Treasury writing the check or the FDIC writing the check after the remaining \$50 billion of private capital is lost?
- The FDIC and the Treasury are both agents of the same govt.
- Functionally, there is no difference.

# Understanding TARP (cont.)

- All the TARP did was allow the bank to continue operations as usual with \$50 billion in private capital rather than with the required \$100 billion in capital.

# Understanding TARP (cont.)

- The TARP was identical to what is called 'regulatory forbearance.'
- In fact, no Federal moneys were 'spent' as banks are not liquidity constrained in any case.
- The TARP did not add to aggregate demand.

# Understanding TARP (cont.)

- There was no need to have Congress pass TARP to allow failed banks to continue to function
- There was no reason to expend the enormous amounts of political capital and give the appearance that \$billion were being spent.
- This shows no one in Congress, the Fed, the Treasury, the Administration, or private economists understood banking fundamentals.

# Comments on the Stimulus Program

- Unemployment is people looking for paid work who can't find it.
- Unemployment is the evidence of a deficiency of aggregate demand.
- When government spending is insufficient to cover the need to pay taxes and net save financial assets, the evidence is unemployment.

# Comments on the Stimulus Program

- Unemployment can always be quickly eliminated by a fiscal adjustment.
- The government can simply hire the unemployed.
- The government can cut taxes until the private sector hires the unemployed.

# Comments on the Stimulus Program

- A fiscal adjustment was the correct response to high unemployment.
- It should have been done no later than August 2008.
- If done at that time in sufficient size the financial crisis would not have spilled over from Wall St. to Main St.

# Comments on the Stimulus Program

- The belief that the financial sector needs to be fixed first has proven itself wrong.
- In fact, the financial sector makes its profits from a prosperous 'real' sector.



# Comments on the Stimulus Program

- Persistently high and rising unemployment meant the US fiscal adjustment was insufficient to restore output and employment.

# Comments on the Stimulus Program

- The stimulus program turned out to be too little too late.
- A further adjustment can be made at any time.
- Unfortunately our government mistakenly thinks it has 'run out of money'
- It mistakenly thinks spending now requires we borrow from the likes of China to leave to our children to pay back.

# What Can be Done?

- My first proposal continues to be for a full “payroll tax (FICA) holiday”
- All FICA payments are to be made by the Treasury on behalf of all employees and employers.
- This will restore take home pay to levels where sales, output, and employment will rapidly return to full employment levels.

# How do we Pay for It?

- **Government spending is not revenue constrained**
- Government taxes by changing numbers down in our bank accounts.
- Government spends by changing numbers up in our bank accounts.

## How do we Pay for It? (cont.)

(SCOTT PELLELY) *Is that tax money that the Fed is spending?*

(CHAIRMAN BERNANKE) *It's not tax money. The banks have accounts with the Fed, much the same way that you have an account in a commercial bank. So, to lend to a bank, we simply use the computer to mark up the size of the account that they have with the Fed.*

# How do we Pay for It? (cont.)

- The Fed Chairman is correct.
- All Federal spending is done simply by marking numbers up with their computer.
- The same way the bowling alley gives you your score.
- It doesn't 'come from' anywhere.
- There is no such thing as the Federal government 'running out of money.'

# What about China?

- China gets dollars from selling things to us.
- Those dollars go into China's checking account at the Fed (Federal Reserve Bank).
- Treasury securities are savings accounts at the Fed.
- When China buys Treasury securities their dollars are transferred from their checking account to their savings account at the Fed.
- To pay China back we transfer their dollars from their savings account to their checking account.

# So Why does the Federal Government Tax?

- Federal taxes function to regulate aggregate demand, not to raise revenues per se.
- Federal Taxation is like the thermostat
- If the economy is ice cold, like it is today, and government is at the 'right size,' a tax cut is required to bring it up to operating temperature.



# Trade

- Exports are always 'real' costs
- Imports are always 'real' benefits
- Economics is the opposite of religion
- It is better to receive than to give.

# Trade (cont.)

The real wealth of our nation is:

- All it can produce domestically
- + all it can import
- - all it exports

# Trade (cont.)

- The trick is to keep taxes and Federal spending at the right level
- so that we have enough money to buy all we can produce domestically at full employment
- and buy all the rest of the world wants to sell US.

# Trade (cont.)

- Unfortunately, we don't respond to an increase in imports with an appropriate tax cut or spending increase
- and the result is unemployment
- as we turn a good thing into a bad thing