The new bank plan

by The Milwaukee Journal Sentinel

Wall Street loved the Obama administration's new bank rescue plan. News that Treasury Secretary Timothy Geithner finally had put some flesh on his bare-bones ideas helped push up the Dow Jones industrials up 497.48 points Monday.

But should the rest of us love it so much?

That all depends on whether it works, and this is a plan fraught with risk. It's also one that might not go far enough.

The heart of the Obama-Geithner plan is up to $100 billion of capital from the government's existing bailout fund, the Troubled Assets Relief Program. That money, along with cash provided by private investors, will leverage financing from the Federal Deposit Insurance Corp. and the Federal Reserve to buy billions of dollars of toxic assets that are clogging the balance sheets of the nation's big banks. Initially, the partnership would provide up to $500 billion of financing, although that could quickly grow to as much as $1 trillion.

By subsidizing private investors, the Obama plan provides strong incentive for them to step up â€” and some indicated Monday they would do so. The FDIC would tap its credit lines with the Treasury and lend $6 for every dollar invested by the Treasury and private investors.

The marketplace would establish values for the assets based on an auction by the FDIC.

But it's questionable whether this plan is either ambitious enough or efficient enough to create a market for mortgage-backed securities where there is none now. As the housing market imploded, the value of the securities held by many of the largest financial institutions plummeted and then became difficult to ascertain as markets for them collapsed. The resulting credit crunch eventually bled into the economy generally, and the economy won't fully recover without fixing this fundamental problem.

But will enough investors emerge? Will the auctions actually jump-start a market? Will the auctions reflect market pricing? And most important: Will banks that are now essentially insolvent be saved?

The government has invested billions of dollars to unclog the credit markets, and billions more will be needed. This new plan might just work. But there is also a large risk that in the end the government will still have to take direct control of several large institutions that are now essentially insolvent. The administration has resisted this reality, but there might be no way around it.

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