Geithner's big week with Congress, bank plan

The Treasury secretary begins to find his footing after a shaky start.

By Mark Trumbull | Staff writer/ March 24, 2009 edition

Embattled Treasury Secretary Timothy Geithner moved into image rehabilitation mode this week, even as he faces continued criticism that his economic rescue plans are showering undeserved benefits on firms such as AIG.

Public outrage over bonuses paid at that bailed-out insurance firm won't be easy to defuse, especially as more Americans lose their jobs. On Tuesday, Mr. Geithner was in the hot seat again on this issue, at a Capitol Hill hearing.

Being point man for bailouts is just one challenge he's faced in a shaky start that has stirred talk about whether President Obama might have to replace him. But it now appears that Geithner will stand or fall by whether his policies work going forward, not on early missteps. Among the signs:

- His plan to deal with so-called toxic assets of banks, unveiled Monday, was better received than an early outline of his bank-rescue plans.
- At the hearing Tuesday, concern about AIG was channeled partly in a positive direction: on the need for legislation so that in the future the government can better manage the shutdown of large failed firms that pose a risk to the economy.
- Mr. Obama has voiced strong support for his Treasury chief.

"The only thing that matters here is the judgment of the president," says Robert Shapiro, who served President Bill Clinton as undersecretary of Commerce for economic affairs, now at NDN, a left-leaning think tank in Washington.

Obama's own job performance is now tethered closely to the success of his Treasury secretary. He selected Geithner, after all, and has endorsed his latest rescue plans.

For Geithner's part, his job security hinges on how well his plans work in the months ahead, Mr. Shapiro says.

The Obama administration, however, confronts a risk related to Geithner's policies, he adds: "The larger issue is whether the administration either has been or will be too deferential to Wall Street."

Geithner falls into one camp of finance experts who say the best way out of the financial mess is to nurse banks back to health without putting them under full government control. The main rival view, held by Shapiro and others on both the right and left, is that some large institutions may be insolvent and would be most efficiently resolved through temporary nationalization.

Politically, the Geithner course means that populist ire over bailouts could persist in coming months. Obama is already navigating delicately on this issue, affirming his own frustration with Wall Street while making the case that economic recovery hinges on more help for banks.

Economically, Geithner’s bank-rescue strategy carries its own risk. The true health of banks is a central uncertainty for the economy now. The worse off banks are, the more likely it is that nationalization of weak banks would be a cheaper and quicker way to resolve the problems.

Just as Japan experienced a “lost decade” after an ineffective bank cleanup, a US economic recovery could be tepid and prolonged without an effective bank fix.

It’s a matter of hot debate among finance experts. Many say that Geithner’s approach can work and that more drastic measures should be a last resort.

“The proponents of nationalization seem to be dramatically underestimating the difficulties … of that approach,” says Douglas Elliott, a former investment banker now at the Brookings Institution in Washington.

Necessity of fixing the banks

Whatever approach is right, fixing the banks is widely seen by economists as a must, to give the economy a shot at normal growth after the current recession.

In this sense, despite all the populist outrage in the air, Wall Street and Main Street are closely joined.

Geithner has been working full-bore to address the crisis, but he confronts numerous challenges.

He weathered some controversy over personal income-tax mistakes. His first major speech, giving the outlines of his overall “financial stability plan,” was widely panned as too vague. He’s been slow to fill key positions around him at Treasury, announcing some this week.

Then came the revelation that AIG employees had received $165 million or more in bonuses, even as the firm has been costing taxpayers billions.

By last week, some Republican lawmakers were calling for Geithner to go.

Obama is standing by the secretary and was literally at his side earlier this week to support the toxic-asset plan. When appearing Sunday on CBS’s “60 Minutes,” the president said “no” when asked if Geithner had offered to resign.

“He shouldn’t,” Obama said. “And if he were to come to me, I’d say, ‘Sorry, buddy. You’ve still got the job.’ ”

Obama will own the results of the Treasury policies. He knew in selecting Geithner that he was choosing someone who, as president of the Federal Reserve Bank of New York, was an architect of financial rescue moves begun last fall, including that of AIG.

Geithner, Bernanke offer explanation for AIG

At Tuesday’s hearing on the Hill, Geithner and Fed Chairman Ben Bernanke appeared together in the House to defend their AIG actions.

Mr. Bernanke said AIG’s collapse would have been handled much differently last September had the government had in place a framework for coping with the failure of a large nonbank firm.

Back then, officials say, the choices essentially were a full bailout (as at AIG), with the resulting onerous costs, or a bankruptcy (as at the investment firm Lehman Brothers), which can stir chaos in financial markets.

Geithner and Bernanke argued that with a different system, such as the one that allows the Federal Deposit Insurance Corp. to resolve failed banks, the balance between taxpayer costs and economic fallout could be better managed.