IS GEITHNER PLANNING ON A PUBLIC-PRIVATE PARTNERSHIP WITH THE SOVEREIGN WEALTH FUNDS?

The big gimmick to Tim Geithner's new plan to ~~avoid nationalizing the banks~~ save the big banks is a public-private partnership.

> Public-Private Investment Fund: One aspect of a full arsenal approach is the need to provide greater means for financial institutions to cleanse their balance sheets of what are often referred to as "legacy" assets. Many proposals designed to achieve this are complicated both by their sole reliance on public purchasing and the difficulties in pricing assets. Working together in partnership with the FDIC and the Federal Reserve, the Treasury Department will initiate a Public-Private Investment Fund that takes a new approach.
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> - *Public-Private Capital: This new program will be designed with a public-private financing component, which could involve putting public or private capital side-by-side and using public financing to leverage private capital on an initial scale of up to $500*

> *billion, with the potential to expand up to $1 trillion.*
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> - *Private Sector Pricing of Assets: Because the new program is designed to bring private sector equity contributions to make large-scale asset purchases, it not only minimizes public capital and maximizes private capital: it allows private sector buyers to determine the price for current troubled and previously illiquid assets*

There are a couple of sources of private money available on the scale that is necessary to help out: billionaires like Warren Buffett (net worth, $62 billion), pension funds (total assets as of last September, before the crash, $28.1 trillion), mutual funds (total assets before the crash, $26.2 trillion). While Buffett has shown some willingness to bail out these banks for the right price, I can't see pension and mutual funds wanting to take on the risk.

And then there's a source of funding that the big banks have already turned to in an effort to stave off this crash–a source which has a lot invested in forestalling nationalization: sovereign wealth funds (total assets before the crash, $2.7 to $3.2 trillion, and expected to grow to between $5 and $13 trillion). SWFs, of course, are the investment arms of oil producers like Saudi Arabia, Kuwait, and the UAE, and exporters like China, Singapore, and South Korea.

I’m particularly interested in whether or not Geither is expecting sovereign wealth funds to be involved in this public-private partnership because of the role they had in "saving" a few big banks between November 2007 to January 2008. The GAO describes these investments to include:

> November 27, 2007: Abu Dhabi Investment Authority invests $7.5 billion in Citigroup for a 4.9% stake in the company.
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> December 19, 2007: China’s SWF invests $5 billion in Morgan Stanley for a 9.9% stake in the company.
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> December 24, 2007: A Singapore SWF and Davis Selected Advisors invest $6.2 billion in Merrill Lynch for a 13% stake in the company.
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> January 14, 2008: Kuwaiti and South Korean SWFs, and Mizuho Bank of Japan invest $6.6 billion in Merrill Lynch for an undisclosed stake in the company.
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> January 17, 2008: Singaporan and Kuwaiti SWFs (and Saudi Arabia’s Prince Alwaleed bin Talal) invest $12.5 billion into Citigroup for an undisclosed stake in the company (as of November 2008, bin Talal personally owned a 5% stake in Citi).

So basically, the investment arms of a bunch of foreign countries dumped tons of money just a year ago into banks that were already hemorrhaging money. I’m guessing those investment arms have been lobbying pretty hard for Geithner not to nationalize these companies, which would have meant they would lose billions.

SWFs are reported to have invested further, even larger funds into failing banks last year (including an additional $50 billion into Citi) but there appears to be much less reporting on these investments–since the GAO report on SWFs came out just before the crash, attention seems to have turned to TARP at the expense of the SWFs. And all this investment in US banks comes on top of huge stakes SWFs have taken in Barclays and UBS, as well as China's SWF nearly investing in a huge stake in Bear Stearns.

There are two big problems (at least) with SWFs owning such big stakes in these banks. It is already hard to separate foreign policy issues from economic issues: but if nations can devastate our economy with their actions on our biggest bank, it risks severely constraining our foreign policy. Further, some of these loans give the SWFs further equity starting in 2010, at which point the SWFs may have even more flexibility to mess with these companies. And to what degree is Geithner's refusal to nationalize the banks driven by the demand from these foreign countries that he not make their considerable stakes in the banks worthless? To what degree are we focusing on fixing Wall Street—to the neglect of Main Street—because these powerful investors don't want to lose their billions?

But also, what would it mean for the US to engage in a "public-private partnership" with what are essentially other countries? There is some review of SWF acquisitions under CFIUS.

> CFIUS and its structure, role, process, and responsibilities were formally established in statute in July 2007 with the enactment of the Foreign Investment and National Security Act (FINSA). FINSA amends section 721 of the Defense Production Act to expand the illustrative list of factors to be considered in deciding which investments could affect national security and brings greater accountability to the CFIUS review process.11 Under FINSA, foreign government-controlled transactions, including investments by SWFs, reviewed by CFIUS must be subjected to an additional 45-day

> investigation beyond the initial 30-day review, **unless a determination is made by an official at the deputy secretary level that the investment will not impair national security**.12 CFIUS reviews transactions solely to determine their effect on national security, including factors such as the level of domestic production needed for projected national defense requirements and the capability and capacity of domestic industries to meet national defense requirements. If a transaction proceeds to a 45-day investigation after the initial 30-day review and national security concerns remain after the investigation, the President may suspend or prohibit a transaction. According to Treasury, for the vast majority of transactions, any national security concerns are resolved without needing to proceed to the President for a final decision. **The law provides that only those transactions for which the President makes the final decision may be disclosed publicly**. [my emphasis]

But so long as a Deputy Secretary—say, working for Geithner, whose plan this is—decides these investments won't harm national security, it appears to escape all meaningful review.

And with a "public-private partnership," we would be insuring their investments and they would basically be giving us chunks of their surplus dollar reserves in hopes of staving off total failure of these investments. What happens when—as the economists who predicted this crash expect—the banks are ultimately nationalized? What will we owe Kuwait or Singapore at that point?

I'm not sure that Geithner is thinking of partnering with SWFs for this latest TARP. But it's a question that Robert Reich seems to be pondering. I just wonder whether the whole refusal to nationalize the banks comes out of a last-ditch effort on the part of Geithner and the SWFs to prevent them from losing their shirts.

Update: Here’s a recent WSJ column on this:

> How long will Asia’s sovereign-wealth funds remain a sleeping tiger when it comes to their plummeting investments in Wall Street banks?
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> [snip]
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> Ed Greene is a partner with law firm Cleary Gottlieb who has lectured around the country about sovereign-wealth funds and worked as the general counsel of Citigroup’s investment bank until recently. **He told Deal Journal Thursday that U.S. banks probably will need to entice sovereign-wealth funds to pour more money in. The enticement this time? “They will look for investments where they can have influence or control**,” he said. “The investments where they lost money have been passive.”
>
> [snip]
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> **If sovereign-wealth funds do become more-active participants in U.S. banks in return for more money, it will provide some interesting twists in America’s approach to foreign investment**. When these government investment funds first put money into the banks, the U.S. government wasn’t a fellow shareholder; now, through the TARP $700 billion, it is. The U.S. government will be the most powerful shareholder in these banks. That could result in a certain amount of tension if bank managements, federal officials and foreign shareholders disagree about how best to preserve the value of the banks’ shares. [my emphasis]