



## Goldman Sachs' Challenge to Treasury

*Simon Johnson argues that Goldman Sachs' decision to return Federal bailout money could lead to new instability in the banking system.*

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Our guest is Simon Johnson, senior fellow at the Institute, professor at MIT, former chief economist at the IMF, and ongoing blogger and commentator on the financial system in the United States and the world in the current global downturn. Welcome, Simon, with all your titles.

Simon Johnson: Thanks for having me.

Steve Weisman: Simon, the news this week is that Goldman Sachs, the giant investment banking firm, wants to give their federal bailout money back so they can get out from under some of the regulations, and perhaps scrutiny, imposed by Congress and that already exists in the various web of regulators in the United States. Would it be a good thing for Goldman Sachs to do this?

Simon Johnson: It obviously would be good for Goldman Sachs. That's the point they've been making. They want to pay back the TARP funds, specifically to get out from the executive compensation limits, and the constraints that exist right now on bonus payments made by TARP recipients. And there are some other restrictions that they may want to relax. So from a competitive point of view, if they can go out and pay top dollar for talent, I mean, this is the kind of language they're using, this will let them pull in better people and give them a big leg up over other people, who are at other firms—financial firms—who are on the TARP program who can't go out and hire so aggressively.

Steve Weisman: They also argue that giving the money back will be a sign that they're more solvent than thou or than their competitors.

Simon Johnson: Yes. It would definitely be a sign and a signal that Goldman Sachs has got an advantage going forward, and that people presumably would look at that and think about doing business with them, because they've demonstrated their financial stability.

Steve Weisman: Should it be taken as such a step? After all, Goldman was favored with a lot of rescues early this year and last year. Presumably, Goldman investors know that should there be a downturn, the Federal government might step in again. Is it right for Goldman to say, "Aha, we're on our own now"?

Simon Johnson: I think it's complicated and a kind of a tricky thing from the point of view of the overall financial system. We know from a story in the New York Times that the Federal

Reserve sent an email to all the banks involved in the so-called stress test, asking them not to disclose the results of their stress tests and specifically asked them not to talk about their plans to raise capital immediately, because that would send a signal that while Bank A may be strong and able to raise capital, other banks are not in the same position. And so, while it may help Goldman Sachs to do what they're doing, it's going to disadvantage other banks, disadvantage to the point of perhaps jeopardizing system stability, which is not, I understand, the primary concern of Goldman Sachs. But it is the primary concern and responsibility of the Federal Reserve and the other supervisors.

Steve Weisman: Was it right of the Treasury to ask Goldman not to “toot its own horn” that way?

Simon Johnson: Absolutely. I mean, the Treasury and the Federal Reserve and the other supervisors have a responsibility to safeguard system stability, and I think that they are trying very hard to do a good job. But it's a difficult position that they're in. They have faced enormous pressures from the financial industry, and I think this is a perfect example that not only is Goldman Sachs happy to take the taxpayers' money when the going is tough; when things get a little bit easier, they want to pay it back and get out and go about their business. The old saying, Steve, of course is: “Wall Street owns the upside; the taxpayer owns the downside.” Well, today, tax day, April fifteenth, is kind of an appropriate day to be reminded of that by Goldman Sachs.

Steve Weisman: Of course, Goldman Sachs, even if it returns the TARP money, has hardly severed its ties with the federal network of bailout programs. For instance, it still has FDIC-guaranteed loans, it still has access to the discount window set up by the Fed last year. Isn't it correct to see Goldman as not a ward of the Federal government, but at least very much beholden to the Federal government?

Simon Johnson: That's my position. And I think that has been the position of Treasury and the Fed. Obviously, Goldman Sachs is pushing back. Goldman Sachs has a lot of political muscle, as you know, a lot of connections on Capitol Hill, a lot of alums of Goldman Sachs in various positions around the administration. To me, at least, this is going to be one of the defining political moments and struggles of the Obama administration. If they can face down Goldman Sachs, then some of the most powerful people on Wall Street can say, “Guys, get back in line, you'll get your bonuses in due course. Right now, we've got to watch out for financial system stability.” That will be one thing. If they cave in, if they let them pay back the money, let them get out from under the executive and broader compensation limitations, then I think we have a more difficult future ahead of us.

Steve Weisman: Is the Obama administration correct in saying, “Don't give us the federal money back”?

Simon Johnson: Obviously at some point, we would like to get our money back. The losses that we've incurred supporting the financial system are serious, and they're much bigger than just the money that was put into Goldman. So the more we can recoup, the better. But we want the money back on appropriate terms, on terms that will engender system stability. The worst possible situation would be: Goldman gets to pay back its money, which causes further problems, and other banks lose business, suffer more losses,

and therefore we have to throw more money in there. So from an overall taxpayer point of view, it's not clear just on a dollar basis that we'll get the best value by letting Goldman jump the line and pay back before everybody else. I think the government is trying to manage an orderly process here, and while I've been critical of them, it's true, on a number of dimensions, I think they are moving things in the right direction. Goldman, I think, is threatening to derail their process right now, and they should be told to stop it.

Steve Weisman: So, this whole process of the stress test, the public-private investment partnerships, which you've expressed skepticism about, is threatened with being upended by Goldman's action?

Simon Johnson: Well, I don't want to exaggerate. I mean, it depends on many events and how things play out. But what Goldman is suggesting that it will do or saying that it will do, stating bluntly that it's going to do, directly contravenes, according to the New York Times, what the government asked them to do. And I don't think the government, the Federal Reserve, is in the business of sending frivolous emails. I think we haven't seen the exact email, but I gather that their point was pretty direct: Please wait until we manage this process, it won't take that long. But somehow that's not good enough for Goldman Sachs. I don't quite understand where they get off deciding this, rather than deferring to appropriate authority, which in this case would be the Fed.

Steve Weisman: The stress tests are going on meanwhile, and they probably will show that some of these financial institutions, if not Goldman Sachs, are under some stress. Whether they show that they're insolvent, we don't know. What's your latest view about the credibility of this whole stress test operation?

Simon Johnson: I think the stress test is slightly humorous at this point, because it's not as if they put these banks on a treadmill and they then workout for two months. I mean the stress tests, by all accounts, should take a day or two of additional computer runs. The data is available. The supervisors spend a lot of time in these banks anyway. So quite why it's taken this long is puzzling, except if you think that the government wanted to buy some time and wait for the economy to stabilize and calm down, which of course it has. And I think now, there's a difficult political judgment to be made by the administration. If they let off all the banks and say everybody's fine, it's going to look very weak. If you really come down hard on some of them, that could further destabilize things. And so I think they're going to judge, on a political basis, how much to ask for from certain banks. Certain banks will be required or requested to raise further capital, for example, other banks will not. And they want to manage that package. I've looked at the technical parameters of the stress test, by the way, and this could go either way. It could be implemented on a tougher way or a moderate way. I think it's a very political decision, and I think that's going to be made at the highest levels.

Steve Weisman: You mentioned the politics might lead the administration to be somewhat easy on the banks, on their demands, and then declaring which ones are in trouble. But, couldn't you argue it the other way: that in order for the whole process to have some credibility, they do have to find some banks as troubled?

Simon Johnson: No, I don't think they'd find them troubled. In fact, Secretary Geithner said, "It's not a pass-fail test." I think that means it's kind of like getting an A at Harvard. By all accounts, it's become easier to get an A over the past generation or two.

Steve Weisman: Spoken like the true MIT professor you are.

Simon Johnson: Exactly. So everyone's going to get an A of some kind, but then presumably there'd be some differentiation between A minus and A plus and you know, there are some relatively subtle messages. I think the key point is: Do they push some banks to go out and get further capital, and do they let other banks go out and go about their business? And, obviously, managing these differentiations, managing how some banks emerge looking great and other banks look troubled is a very, very tricky business for the government. They have said that they will make the full stress test available, and I think that's a good idea because otherwise, there will be selective leaking of it and sort of manipulation of the messages.

Steve Weisman: But isn't there a danger of making too much disclosure, causing people to lose confidence in some institutions, and having that rebound on itself?

Simon Johnson: As I said, it's a difficult decision, a difficult process. I think they're better off with more transparency, to be honest. But of course they're entitled to control the message and manage the message. And that's exactly where Goldman Sachs is kind of throwing them off, that if they can't do that, if the big players are coming out and saying, "Well, we're fine, and we already paid back our capital and I'm actually standing here, speaking to you from in front of the Treasury with a check for \$10 billion in my hand, I don't know why no one has come to get it from me." I mean, it looks to me like they're really pushing a little bit too hard, and given all that was done for Goldman Sachs, for example, and by federal banks by this Treasury and by the previous Treasury, they look more than a little bit ungrateful, just on a personal level, to my way of thinking.

Steve Weisman: Well, how much does gratitude really cost on Wall Street? I am not sure that it's a big commodity.

Simon Johnson: I have no idea, obviously. It certainly seems pretty cheap these days. But my point would be about the politics of the situation: It is remarkable and, to me at least, quite reminiscent of things we've seen in emerging markets, like a Korea or Malaysia or a Russia or even in Argentina, where you have very powerful players who feel they can stand up to the government, thumb their nose, or make even less appropriate gestures, and they have the political clout to get away with it. That's extraordinary, and that's not how we're used to thinking about American democracy and American capitalism working. But perhaps we have to update our views.

Steve Weisman: On that note, on April fifteenth, we will certainly have more time to watch how the stress test is implemented and have you back. Thanks a lot, Simon.

Simon Johnson: Thank you.

