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# Wall Street owes its survival to the Fed

*di Sebastian Mallaby*

For a brief, surreal moment, the prevailing narrative in Washington was that the 2008-09 bail-outs were not really so bad. In September, Treasury secretary Tim Geithner called the government's troubled asset relief programme "one of the most effective emergency programmes in financial history", claiming that the final cost to taxpayers would be less than $50bn.

Steven Rattner, the Wall Street banker who oversaw the Obama administration's rescue of the auto sector, wrote in the Financial Times in October that "without exaggeration, this legislation [establishing Tarp] did more to keep America's financial system – and therefore its economy – functioning than any passed since the 1930s".

But Wednesday's document dump from the Federal Reserve – a congressionally ordered "WikiLeak moment" – puts this bargain-bail-out patter in a new perspective. The post-Lehman rescues were far broader than Tarp, and far riskier for taxpayers, even if the alternative of a systemic meltdown would have been worse.

The Federal Reserve's revelations underscore the might of unelected central bankers. The Treasury's Tarp rescue fund, at $700bn, was considered so audacious that Congress at first refused to authorise it. But the Fed doled out no less than $3,300bn in loans to banks and companies without a congressional say-so.

What's more, the Fed frequently ignored Walter Bagehot's dictum that central banks should provide liquidity freely, but against good collateral and at high interest rates. The Fed's borrowers included institutions such as Lehman and Citigroup, which were insolvent rather than illiquid. It accepted collateral that included toxic asset-backed securities, and it charged interest rates that were more palliative than punitive. Moreover, while the Fed took all these risks with US taxpayers' money, a large chunk of its emergency lending went to foreign banks.

In its statement accompanying its data dump, the Fed claimed soothingly to have "followed sound risk-management practices". It is hard to square that boast with the Fed's Maiden Lane facility, which accepted some of Bear Stearns' most toxic assets as collateral for a $29bn loan to its acquirer JPMorgan Chase. The Fed also stated that its "facilities were open to participants that met clearly outlined eligibility criteria". But one wonders about criteria that permitted taxpayer-backed loans to everyone from Verizon Communications and Harley-Davidson to Sumitomo Corp and the Bank of Nova Scotia.

Richard Fisher, president of the Dallas Fed, manfully concedes that the central bank took "an enormous amount of risk with the people's money". But he adds that the risk is now behind us – that the loans have been paid back and "we didn't lose a dime and in fact we made money". He may be right, but it was not clear prospectively. The Fed has yet to recoup the money leant to JPMorgan in the Bear Stearns rescue; and its later Maiden Lane programmes, created to help AIG, have not been repaid either. Indeed, the Fed still has some $29bn of AIG loans on its balance sheet. The collateral backing this largesse includes $9bn of subprime mortgages and other smelly assets of dubious value.

The point is not that the Fed was wrong in its determination to stem the panic following the Lehman bust. Indeed, if the European Central Bank were similarly audacious, the euro-zone might be better off today. The most recent leg of Europe's crisis began when the ECB ran out of good collateral to lend against, and demanded that politicians assume the burden of the bail-out – a role that the politicians predictably bungled. Far better to have an activist central bank that takes ugly risks with its own balance sheet than a fastidious puritan that throws the economy to the elected dogs.

Rather, the point is that the Fed bail-outs were hair-raisingly enormous, and that neither the regulators nor the regulated should be allowed to forget that. Wall Street institutions that now walk tall again survived only because the taxpayers saved them. Goldman Sachs turned to the Fed for funding on 84 occasions, and Morgan Stanley did so 212 times; Blackrock, Fidelity, Dreyfus, GE Capital – all of these depended on taxpayer backstops. The message from this data dump is that, two years ago, these too-big-to-fail behemoths drove the world to the brink of a 1930s-style disaster – and that, if regulators don't break them up or otherwise restrain them, they may do worse next time.