This American Life Episode Transcript
Program #375
Bad Bank

Ira Glass: The news has gotten kind of confusing. I don't know if I'm allowed to say that as a person who talks here, on the public radio. It's confusing, to me. Especially all the stuff about the trouble the banks are in. You know, you turn on *The Today Show* at random, you can find yourself watching something like this:

> TAPE: As of this date, this is the second date, the static date, all these large banks exceed regulatory standards for being well capitalized. Ah, so for right now they're fine...

Ira Glass: That's the chairman of the Federal Deposit and Insurance Corporation, Sheila Behr, and this is mainstream network television, in the morning. God help you if you accidentally flip over to CNBC.

> TAPE: So many of these banks, the stocks are telling you, the underlying equity value is zero, or maybe a little bit above zero.
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> Wouldn't mark-to-market accounting, a hiatus from mark-to-market, do that exact same thing.

Ira Glass: Ok, I'm just going to stop the tape right there. Come on! That's not even trying to help us understand. Even the Obama Administration, whose very jobs depend on us understanding what they're trying to do to try and fix the economy, who are actually trying to explain this stuff to us, even they have these moments.

> TAPE: Those institutions that need additional capital will be able to access a new funding mechanism that uses capital from the treasury as a bridge to private capital.

Ira Glass: This is Treasury Secretary Tim Geitner on Capitol Hill explaining his plan to fix our banking system.

> TAPE: The capital will come with conditions to help ensure that every dollar of taxpayer assistance is being used to generate a level of lending greater than what would have been possible in the absence of government support. And this assistance will come with terms...

Ira Glass: Forget it. Here's what I understand, what I think most of us understand. Stock market is way down. It seems to be dropping. Banks aren't lending. Even though the government has given them hundreds of millions of dollars of our money to help them start lending again. And my life, your life, the entire economic fate of our country, and the world for the next decade depends on whether or not the United States can fix its banking system. And maybe you're on the verge of just giving up, of figuring that this is just going to be one of those news stories that you're just going to kind of sit out, you know? I sat out Kosovo. I'm not proud about that fact, but I did. Well, if that's your situation, I have good news for you. The team that put together our show explaining the mortgage crisis last year, that so many of you wrote to us to let us know that you found so helpful, is the team Adam Davidson (AD) from NPR News, NPR Economics Correspondent, and This American Life Producer Alex Blumberg (AB), they are back. They are back today, and in the next hour, they are going to explain everything you need to know to understand the U.S. Banking system and how it might, or might not be fixed. And, I've got to say, they've been working on this all week, I've heard the thing, it is awesome. It is awesome, and at the end of it, you will actually be able to have an opinion. From WBEZ Chicago, it's *This American Life*, distributed by Public Radio International. Today's show is another collaboration between us and NPR News. the collapse of the U.S. banking system explained in just 59 minutes. Stay with us. And with that, I turn things over into the capable hands of Adam and Alex.

Alex Blumberg: If you want to understand this crisis right now, this banking crisis, you need to understand this one thing. And it's one thing, Adam, that the mainstream media is afraid to touch.

Adam Davidson: They're afraid because they think it's really boring.

Alex Blumberg: Right because, what this central thing is, this thing that we need to discuss right is a bank balance sheet.

Adam Davidson: But please, do not despair, because we think we've come up with a way to explain this to you, and we actually think it will be pretty enjoyable. So, to begin, let's imagine the simplest bank in the world. I would like to call it Adam's Bank.

Alex Blumberg: How come you're always the bank owner in these imaginary scenarios?

Adam Davidson: I mean Alex, I just think of myself as more like a bank owner, and you, more like, more like a bank customer.

Alex Blumberg: Oh, I see. Ok Mr. Fancy Pants, go ahead.

Adam Davidson: Ok, so, I have 10 dollars of my own money that I'm going to start my bank with. So I take these 10 dollars, and I open for business, I start accepting deposits. And I go to my good friend, and colleague, Alex Blumberg, and I say, "Hey, Alex, do you want to open a savings deposit with my bank? I'll give you 3 percent interest a year."

Alex Blumberg: I say, that sounds great, I actually have 90 dollars right here that I am saving for a rainy day and so I will it over to you. Here you go... 80 - 90. here you go.

Adam Davidson: All right. Ok. So now I have 100 dollars in my bank. 10 if which is mine, 90 I got from Alex. All right, so this is a lousy business, I'm losing money. Because I'm paying Alex 3% interest. I'm not getting anything coming in. I need to make some profit. And that requires one other person.

Caitlin Kenney: Hi guys.

Adam Davidson: Hey Caitlin. This is Caitlin Kenney, she is a Planet Money producer. Hey, what's up? What's going on?

Caitlin Kenney: I need to borrow 100 bucks...

Alex Blumberg: For what?

Caitlin Kenney: To buy a house.

Adam Davidson: You can buy a house for $100?

Caitlin Kenney: It's a dollhouse.

Adam Davidson: Oh, actually, this is perfect. I give you, Caitlin, the 100 bucks in my bank, but on one condition. You have to pay me back at a higher interest rate than what I'm paying Alex. So that way, I can make some money. So, let's say 6%.

Caitlin Kenney: Sounds good.

Adam Davidson: Okay, here you go, Alright, that's 100 dollars.

Caitlin Kenney: Awesome. Later.

Adam Davidson: Remember, you have to pay me 6% a year?

Caitlin Kenney: Huh?

Adam Davidson: The mortgage. You...

Caitlin Kenney: I've got to go. Yeah, sure, got it. No problem.

Alex Blumberg: All right, all right...

Adam Davidson: Yeah. I'm in business. This is great. I'm getting 6 percent from Caitlin. I pay 3% to Alex. I get to keep the difference.

Alex Blumberg: Ok. And at a fundamental level, banking is really this simple. You pay your depositors, in this case me, a low rate, and then you lend out money at a higher rate, you keep the difference. In fact, there's even an old banking joke: banking is a 3 6 3 business. Take in money at 3%, you lend at 6%, you're on the golf course by 3 in the afternoon... Bankers...

Adam Davidson: Oh, bankers... (6:22)

Adam Davidson: And this brings us to...

Alex Blumberg: The subject of today's radio drama.

Adam Davidson: Correct. So, what we have here, right now, is the world's simplest bank balance sheet. Picture a piece of paper with a line drawn down the middle. On the right side ... is my ten dollars, the ten bucks that I started the bank with ... and the 90 bucks I got from Alex. On the left side ... is the 100 bucks I gave to Caitlin. If you notice, both sides are equal. Ninety plus ten on the right side, equals a hundred on the left side. And that's why they call it a balance sheet. Both sides have to balance.

Alex Blumberg: Ok, now some jargon. Adam's ten dollars? That's called the bank's capital. The people that own the bank, that's what they own. And when Adam makes his profit every year, you know the difference between what he's getting from Caitlin, and what he's giving to me, that profit is added to the capital. So year over year, if the bank is well run, the capital gets bigger, Adam gets richer. But now the jargon gets completely confusing and backwards because most of us aren't used to thinking like a bank. The 90 bucks that I deposited in Adam's bank, that also has a name, and it's called Adam's liabilities." To me of course, it's not liability, it's a deposit, it's my savings, but to Adam it's a liability. Because, if you think about, he owes me that 90 bucks, he's liable to me for that money. I can withdraw it at any time and he needs to pay me interest on it. To him, it's like a loan I gave him.

Adam Davidson: And, I think we should introduce another piece of jargon...

Alex Blumberg: Sure...

Adam Davidson: That 100 bucks that I gave to Caitlin? That's called my "asset."

Caitlin Kenney: Huh?

Adam Davidson: You have to pay me some money every month. When I think of Caitlin's dollhouse mortgage, I think of it like an investment. I gave you 100 bucks up front, you pay me back 6% a year for 30 years, or however long your dollhouse mortgage is. That is my asset, because you pay me that nice return every year, right?

Caitlin Kenney: Huh?

Adam Davidson: You're going to pay me 6% a year, right?

Caitlin Kenney: Oh, I said that?

Adam Davidson: Yes, you have a mortgage. Yes.

Caitlin Kenney; Oh, ok.

Alex Blumberg: Excellent work, guys. Very nicely illustrated. Ok, so the point is every single balance sheet looks this way. On the left side you have assets, and on the right side you have liabilities plus capital. And they always balance out. And this is true from this very simple hypothetical bank in a world with one depositor and one dollhouse to the largest and most complicated bank that has ever existed: Citibank whose balance sheet I have right here.

Adam Davidson: And Alex, you did not like secretly break into the corporate offices of Citibank, you, that's something you can just print off the Internet, right?

Alex Blumberg: Right. And it says here, what they have. Instead of 100 dollars in assets, of course, they have a little bit more, specifically 1.95 trillion dollars in assets.

Adam Davidson: That's a lot of dollhouses.

Alex Blumberg: Yeah, it is. And I'm reading it right here. Assets - total assets, 1.95 trillion. On the other side, liabilities, 1.8 trillion. Capital 150 billion. Also equals 1.95 trillion. It all adds up. Assets equal liabilities plus capital. Both sides of the balance sheet balance.

Alex Blumberg: So, here's where things get interesting. And here's why we're explaining bank balance sheets on the radio and why you are, we hope, listening with rapt attention.

Adam Davidson: Alex, I really hope they are still with us.

Alex Blumberg: Me too. I hope you're out there. It's getting interesting. It all has to do with Caitlin.

Caitlin Kenney: Hey Adam.

Adam Davidson: Hey Caitlin.

Caitlin Kenney: I can't pay my mortgage.

Adam Davidson: What the ...

Caitlin Kenney: I lost my job. I mean, you didn't ask me about my job in the first place, but now I don't have one. So that money, it's not coming.

Adam Davidson: Oh my God.

Alex Blumberg: Well I mean for a few years there, you bankers were giving out loans to all sorts of deadbeats like Caitlin.

Caitlin Kenney: Hey!

Alex Blumberg: Sorry Caitlin, without checking to se if they had jobs first.

AD: All right, I'm going to kick you out, and take the dollhouse.

Caitlin Kenney: But my baby, my baby! Where will my baby sleep?

Adam Davidson: Caitlin, it's a doll baby. Get out!

Caitlin Kenney: Fine.

Alex Blumberg: Okay, so now Adam's bank owns Caitlin's house and he wants to sell it. But it's a down market in dollhouses. And all the dollhouses out there just like Caitlin's are only selling for 95 dollars, which is a problem for your balance sheet, Adam. Because, now it looks like this. Liabilities, 90 that you owe me, and 10 of your own dollars, equals 100. Assets, one dollhouse, worth 95. Your balance sheet is out of balance.

Adam Davidson: So I'm a good banker, I know obviously the balance sheet has to balance. So, that 90 dollars that's Alex's deposit, that can't change, because if he wants to withdraw it a moment's notice, I have to be ready to give him 90 bucks at any time. The only thing that can change on that side of the balance sheet is my capital. The 10 dollars of my own money I started out with. So, now my balance sheet looks like this: on the asset side, one dollhouse worth $95, on the liabilities side, $90 deposit from Alex, my liability, five dollars in capital, my money. So both sides equal 95, they're back in balance, but with the stroke of an accountant's pen, I've lost five of my own dollars. how do I make it equal? Well that 90 dollars of Alex's money isn't going to change - if he wants to withdraw it, I have to be able to hand him 90 bucks. So the only thing that can change is my capital, the 10 dollars of my own money I started out with. Now, with a stroke of a pen, it's only worth five. I've lost half my money. This really sucks. And this situation I'm in with Caitlin, this is the situation a lot of our biggest banks are in right now.

Alex Blumberg: But much worse.

Adam Davidson: Right, because, instead of one Caitlin, there are millions of them. And they all bought dollhouses at the height of a doll house mania. And dollhouses have lost not 5% of their value, but 10, 20, sometimes 50% depending on where they live. They've gone from being 'assets' ... to 'toxic assets.' That's probably another term you've heard.

Alex Blumberg: So if Caitlin's dollhouse is in fact a toxic asset, if her dollhouse dropped in price, let's say 50%... let's go back to our balance sheet. If the bank - you, Adam - takes over Caitlin's dollhouse, and can only sell it for only 50% of it's value, then your balance sheet looks very bad. A 50 dollar loss on the left side of the balance sheet, which has to be matched on the right.

Adam Davidson: So my 10 dollars, my capital, that's totally gone.

Alex Blumberg: And 40 of my 90 dollars is gone as well.

Adam Davidson: So, not only is my bank wiped out, but also I can't even pay back my creditors, in this case, my good friend and colleague Mr. Alex Blumberg.

Alex Blumberg: And this is of course, a bad thing. I lose half my savings. Adam loses his bank. And it's all because of Caitlin and her stupid dollhouse!

Caitlin Kenney: Oops.

Alex Blumberg: Is that all you have to say?

Caitlin Kenney: Sorry!

Alex Blumberg: Ok. There might be a way out.

Adam Davidson: I don't want this whole scenario to happen, and so I come up with a plan, I'm not going to sell Caitlin's dollhouse.

Alex Blumberg: But what about my money? Isn't it only worth half of what she paid for it? You have to sell it, I have to get something back, right?

Adam Davidson: Alex, don't worry about that. your money is still totally safe in my bank. Because let me tell you something, the dollhouse market is coming back. And, all I have to do is just keep Caitlin's dollhouse on my balance sheet, for more or less it's original value, and I have a simple claim. The market for dollhouses is illiquid right now, in other words, I am not able to sell the dollhouse, into this market, so there's no way to determine a market price. We're fine we just have to assume the market is going to come back, and I can sell it for a hundred bucks down the road.

Alex Blumberg: But that's a crazy assumption. we're entering maybe the worst recession in decades. People are losing jobs all over the place. Everyone says things are probably going to get worse in the short term, not better.

Adam Davidson: Shhhh! Alex, I've chosen to believe that this house will be worth more one day. Can you let me have my dream. If we just assume the dollhouse hasn't gone down in value, everything is okay.

Alex Blumberg: That's funny, I talked to a professor at Columbia Business School. He's an expert in bank crises and a former banker himself. David Beim's his name. He told me you'd say that.

> TAPE: Most often, the banker's say, well, it's not as bad as that. For example in the current crisis, many banks hold these so-called toxic assets, whose quoted prices are down around 20% or 30% of their face value, and the bankers say sure, I'm sure it's worth more than that. I don't want to mark it to market.

Alex Blumberg: Okay that last phrase, that he just said, let's listen again.

> TAPE: They don't want to mark it to market.

Alex Blumberg: David Beim is saying, you don't want to mark it to market. Mark to market, that's another phrase you might have heard. And it applies to exactly the situation Adam is in right now. He's got a dollhouse on his books for 100, but if he had to sell it now, he could only get 50 - that's the market price, what he could get right now. Marking it to market means Adam would have to enter the market price - 50 dollars - or 20 dollars - or whatever it really is - into his books.

> TAPE: And the bankers have all been saying 'please don't make me do that,' because if you do, I'll be declaring bankruptcy. If I show all those, the reduction from 100 all the way down to 20, you've just wiped out my entire capital and more, I'm going to have to go to the government and say, close me down, I'm broke. And bankers find that hard to do. and furthermore, regulators don't want it to happen to all the banks at once. Certainly not all the big ones.

Alex Blumberg: Now obviously, in the real world, the assets that the banks have on their books are more complicated than dollhouses. But, if the banks had to sell them now, in today's market, they'd almost certainly take a huge loss. A loss big enough to wipe out their capital and shut them down.

Adam Davidson: And it's not just a few banks. Banking experts estimate that more than a thousand banks are either facing this situation right now or they will soon. And that includes - and this is the crucial point - many of America's largest banks. They owe more money than they have. There's a word for this: insolvent. You don't have to take our word for it. One of our colleagues on the Planet Money Team David Kestenbaum talked to Jeremy Siegel, who is--it's true--called the Wizard of Wharton. Wharton of course, being that famous business school.

> TAPE: How many banks right now do you think would be insolvent, if some one hard-headed, as you say, came in and valued what they actually have?
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> Well I don't know how many, but I think there might be, and the market might be undervaluing some of these, On a current market value, and again the market might be under-discounting some of these probably, wouldn't be surprised if Citi and Bank of America, really, at current value of their assets, don't cover depositors and bond holders and would wipe out shareholder equity and there could be others too.

Alex Blumberg: Let's just pause there. When they talk about the banking crisis--this is what they mean. This is it. Siegel is saying two of the biggest banks in the US, their assets are too small to cover their liabilities. The losses wipe out the capital and there's still not enough left to pay the depositors and all the other people who lent them money. That is just huge.

Adam Davidson: Yeah that quote makes me nervous. Though I do want to be clear about something, normal people, depositors like Alex with a regular savings account, they would not lose any money under any scenario. Because the government guarantees their deposits up to 250,000 dollars. But big banks get lots of their money from big investors who lend them millions or billions of dollars, and that money's not protected. If the banks go down, these investors could lose their money, and the consequences of that will ripple around the world.

Adam Davidson: Of course, Citibank and Bank of America dispute the claim that they're insolvent. They both say they have more than enough capital and there's no need to worry. But it seems the market doesn't believe that story. Consider this fact: Citibank claims on its balance sheet that it's worth, it's own capital, is worth more than $150 billion. But if you add up all the stock out there, which is how you find out what the market thinks Citibank is worth right now, stock right now? I'm going to look it up right now. Okay, as of Friday morning when we are recording this, Citibank's total value according to the stock market, the world's investors, is less than $10 .

Alex Blumberg: That's actually about the size of the Heineken Beer Company.

Adam Davidson: Less than the size of the Heineken Beer Company. And Citibank historically has been one of the largest companies in the world.

Alex Blumberg: So what you see here is two stories. What the banks are saying about their balance sheets. And what people outside the banks are saying. The government, by the way, is siding with the banks for now.

Adam Davidson: They believe that the dollhouse value will go up. That if we just wait a little while, the dollhouse value will go up.

Alex Blumberg: Which is important to know, because what you do about the banking crisis depends on which version of the truth you believe. And the Secretary of the Treasury and the federal government say - now anyway - that Citibank and all the major banks are well capitalized ... and just need a little cushion for insurance.

Adam Davidson: All right, so this is the situation our country is in. If the Wizard of Wharton and the stock market are right, two of our largest banks are either insolvent, or really, really, close - and probably lots of others as well. Those two banks--Citibank and Bank of America alone--have over a quarter of all the money in the US banking system. 90% of all the money anybody has on deposit in the US is in just the 20 largest banks. If they start falling, the US economy, the world economy, are, basically, done for a while.

Alex Blumberg: So, what do we do? There are two options that have been discussed a lot. One option was the one that former Treasury Secretary Henry Paulson originally proposed, the first TARP. Which you'll remember, stood for

Troubled Asset Relief program, and now that word might make more sense. The idea there is pretty simple. You take Caitlin's dollhouse as a typical troubled asset. It's selling right now for only 50 dollars. Under this plan the government agrees with Adam that someday the market will pay a lot more for that dollhouse ... and so it buys it from Adam for a higher price than he could get now ... let's say 92 dollars.

Adam Davidson: Ok. I'd still take a hit to my capital, I'd lose a lot of my money - 8 of my 10 bucks, but, I'd get to keep my bank, and I'd keep my depositors, like you Alex, whole.

Alex Blumberg: But. we the taxpayers get stuck with a 50-dollar dollhouse that we paid almost 100 dollars for. And if dollhouse prices don't go up, it turns the government into a pretty big sucker, and this plan bails out people like Adam, even though he's the guy who got us into this crisis. by making unbelievably stupid loans to deadbeats like Caitlin.

Adam Davidson & Caitlin Kenney: Easy pal.

Alex Blumberg: Sorry guys, I got carried away. Anyway, the government can't pay less for the dollhouse, can't get a better deal, because if it gets a good deal, if it only paid what the market would pay, that wouldn't save the banks. That would defeat the whole purpose.

Adam Davidson: Now, I just want to say, that I, as a banker, I love this plan. I think it's brilliant, because sure, I'll lose some money but I'm still in business. I'm solvent. And it's not just me, all my banker friends think this plan is brilliant. I talked to Simon Johnson, he's an economist, who used to be with the International Monetary Fund, now he's with the Peterson Institute, and he found a good example of another banker giving the hard sell for this plan.

> TAPE:
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> Adam Davidson: So, you brought in a piece of paper today. This is having you laugh. Can you tell me what this is.
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> Simon Johnson: It's a note from Deutsche Bank, it's part of their US daily economic notes.
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> Adam Davidson: These are some staff economists there...
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> Simon Johnson: Yes, and they send these around to clients, and to people they want to have conversations with. Of course, goes to government, these are very influential these kinds of things. So this research note, can I just

plunge in, to say what's in it? The title is eye-catching: Falling Short: The Government Needs to Buy Toxic Assets. So it's a very straight statement, and it speaks to issues of the week. And the paragraph, it's a one-pager. And the paragraph, the bold text, that really struck me and I think summarizes the tone of it is, it says "Ultimately, the tax payer will pay, one way or another, either through greatly diminished job prospects and/or significantly higher taxes down the line. We think the government should do the following: estimate the highest price it can pay for
the various toxic assets residing on financial institution balance sheets, which would still return the principle to the taxpayers. Now, if I can cut through the, if I can translate that...

Adam Davidson: You have a phrase for this note.

Simon Johnson: This is a robbery note. It's saying guys, either you'll have 20% unemployment, and it will go up to these dangerous levels, unless you buy toxic assets, not for what they're worth, not for what the market price is, but for as much as you can pay.

Adam Davidson: Wow. So, the key line here is the taxpayer will pay one way or another. I had a landlord, I don't think he was in the mafia business, but he tried to cultivate the image, and he'd say things like, 'There's an easy way, and there's a hard way.' And I could just hear him saying, you're going to pay one way or another." and so basically what this note is saying is, look guys, you're going to hurt either way, give us the money and we'll try to make it easy for you.

Simon Johnson: My first reaction was it's a spoof. My second reaction was, Oh My God.

[PHONE RINGS]

Adam Davidson: We figured Simon should argue it out with the Deutsche Bank guy, Joe Lavorgna.

Joe Lavorgna: Joe Lavorgna.

Adam Davidson: Hey Joe, It's Adam Davidson from NPR.

Joe Lavorgna: Hi.

Adam Davidson: Hi, so I'm on the line with Simon Johnson. Your note today, did you write it, or did you write it with your staff?

Joe Lavorgna: Me. I wrote it.

Adam Davidson: You wrote it?

Joe Lavorgna: Yes. I wrote it.

Adam Davidson: Simon was actually really nervous about calling Joe. He he'd get all mad at us for calling it a robbery note. But Joe was cool.

Joe Lavorgna: I think the bottom line is simply, someone has to pay for the mess that's been created and there's no escaping, the taxpayer is on the hook

Adam Davidson: Let me just say Joe Lavorgna is finally coming out and saying something that every other bank and lots of government people have avoided saying. They've been playing this game--saying there's some magical recipe where the government bails out the banks, the banks do better, and the taxpayers end up making money. Everyone wins. And this note is saying what I keep hearing from economists--that probably can't happen. Someone is going to lose. And Joe is saying he knows exactly who's going to lose: you, and me, and everybody who pays taxes.

Simon Johnson: I think Joe, I found it refreshingly honest, but it also kind of took my breath away. And the reaction, so I just kind of put it out there, and I asked people what they thought, on my blog, I didn't use names. I just put out this key paragraph, discussing that the taxpayer will pay, one way or another. So one guy said, quote, he's sort of paraphrasing how he read the note, he said: That sure is a nice global economy you've got it. Be a shame if anything happened to it.

Adam Davidson: And Joe, I've got to say, what I love about your note. Do you mind if we call it a ransom note?

Joe Lavorgna: If I was on my own, I'd say fine, but I wouldn't say ransom note, I would say a reality check. I mean I think Simon's exactly right, and I think here's the issue. We're delaying the pain, and you've got to just, you've got to deal with the problem. What we've done up until this point has just simply not been aggressive enough. Whatever the approach is, let's just get there. (25:55)

Adam Davidson: So let's talk about a second way the government could address this whole mess. The government could say to bankers like me, okay dude, let's get real. I would have to recognize my loss on Caitlin's dollhouse. So, I'd just have to say, yes, I am 50 dollars in the hole. So, my capital is wiped out. And I owe my depositor, Alex 40 bucks. But in the second plan, the government comes in on the other side of my balance sheet and covers my losses - it gives 40 dollars for Alex, and it replaces the 10 dollars in capital that got wiped out that I lost. Now, the problem is, if the government puts in that much capital, then the government now owns the bank. My bank! Can I just say, as a bank owner, I don't like this plan. I lose all my money. I lose my job. And I'm a banker, I don't like this kind of government takeover of private industry. It's nationalization. I hate nationalization. This seems like socialism to me.

Alex Blumberg: Yeah, but, at least this way, I as a taxpayer have an ownership stake in a bank. Not some crappy overvalued dollhouse. The government will clean the bank up, sell it to someone else down the road, and we'll get our money back. And frankly, I like that you lose your job and your money. You got us into this mess. Oh, now I hurt your feelings, I'm sorry. I wish you could keep your job, but do you know what I am saying? I'm mad, we're all mad. And, this is the traditional way governments usually fix banks.

For the last 20 years, Simon Johnson has worked on banking crises all over the world. He used to be the chief economist for the International Monetary Fund, an organization that's stepped in over and over around the globe, to fix just the kind of crisis we're in now. And the IMF with the United States pushed countries in similar situations to do what? To nationalize their banks - temporarily.

> Simon Johnson: Indonesia, 97, Korea, 97, 98, Russia, every couple of years, Argentina, in 2002. You know, what would the U.S. tell the IMF to do if this were any country other than the U.S.? If you covered up the name of the country, and just showed me the numbers, just show me the problems, talk to me a little about the politics in a generic way. With the financial system, you have a boom, and then the crash, what would the U.S. tell the IMF to do, I know what we would do, I know what the advice would be, and that would be, take over the banking system. Clean it up, re-privatize it as soon as you can.
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> Alex Blumberg: So then the logical follow up is: Why? Why is the United States not taking its own advice?
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> Simon Johnson: That is a great question. A huge question. My take is that it's too political. The politics are awkward. Remember, cleaning up a banking system, is in my view, technically, is not that difficult. But, when you clean up a banking system, and you do it properly, some powerful people lose. They lose their bonuses, they lose their banks, they lose their access, so who is going to lose? Who is going to decide who is in and who is out, and who, I don't think the people at the top are yet ready to have that conversation.

Alex Blumberg: One of the reasons they might not be ready to have that conversation has to do with the practical challenges of taking over the banks. Columbia Business School professor David Beim knows about this. He has experience himself in taking over American banks, assisting the U.S. government. This was back during our last banking crisis, the Savings and Loan crisis in the late 1980s. When that crisis hit, he started advising the FDIC on the problem, which was big.

> TAPE: Every large bank in Texas and Oklahoma failed in that era. Every one of them.

Adam Davidson: It was the biggest banking crisis America had faced since the Great Depression and, compared to now, it was nothing.

> TAPE: What I faced in the '80s was a regional crisis; so that, the FDIC was willing to shut every major bank in Texas and Oklahoma and cleanse them of their bad loans, re-launch them with new management, and new shareholders. That was the best practice of the day, and they did it very well, and they got through the mess. And they got through it elegantly. It's harder to do that for the nation. It's harder to say, all the big banks should now be closed. (30:01) That is kind of awesome. You would not want to do that all at once. This crisis has advanced so fast and so globally. It's not just the United States, of course, banks are crashing all over Europe. The banks of Europe are actually in worse shape than the banks in the United States. Even the banks that never touched a mortgage backed security. This is a global crisis. It's absolutely everywhere. And under those circumstances it's harder to advocate closing down all the banks.
>
> Alex Blumberg: But, I'm trying to understand, what is the difficulty? Is it simply that you need somebody to sell the assets to, and if you're taking over the biggest banks in the country, there's nobody to sell the assets to?
>
> David Beim: Yes. You can sell one bank. You know, I'm sure you could put some buyers together, there's private equity funds and others who I'm sure could be found for one bank. But to buy the banking system of the globe is sort of a tall order.

Adam Davidson: There's another practical challenge to taking over all of our insolvent banks. The government might just not have enough people to do it. The one time the FDIC actually fully nationalized a U.S. bank – which was Continental Illinois, in 1984 - it took more than a hundred government regulators. Citibank alone is 20 times bigger. And the banking system is far more complicated now than it was then. One expert told me we might be talking about thousands of people needed for each bank we take over. A second problem: Nationalizations are kind of like potato chips. It's hard to have just one. You'd have to come out with a plan for all of them - or all the big banks anyway - and you'd have to do the whole thing in one day, at one time. Because if you just start taking over one bank, people with money at other banks will start worrying that THEIR bank will be nationalized next, and that will cause investors to panic and they'll pull all their money out of that bank.

Alex Blumberg: Now to be fair, there is debate about these logistical arguments. Simon Johnson - the economist who worked at the IMF - says he heard practical arguments against nationalization in every country he went into, and there are ways to deal with all of it, the timing, and the staffing. He said it might be possible, for example, for the government to hold onto the banks for just a few hours before turning it back over to private investors.

Adam Davidson: And so when bankers like me tell Simon that there are all the practical reasons we can't do this in America, he has an answer:

> Simon Johnson: I'm sure they're all sensible Adam, but let me speak as if I were the IMF, acting on the behalf and with the support of the U.S. government in the 1990's. Adam stop with the whining. You know it's got to be done. Just do it. He longer you wait, the more you prevaricate, the more it's going to cost you. This is the U.S. government we're talking about. These people, when they get organized, when they get focused, they get things done. This is the greatest country ever on the face of the earth. We have plenty of talent, there is no shortage of brainpower. Just do it.

Adam Davidson: Now you might have noticed that the government isn't doing either of these options. Instead, they're doing sort of halfway versions of both. They have not committed to buying up all the dollhouses, and other toxic assets, at something closer to their full price. But they have created a new trial program that allows the government to help subsidize private investors, who, they hope, will buy a lot of these assets. And when it comes to option two, the government is not forcing banks to sell their assets, or value them at what they could get on the market right now. The government is not taking over the banks; they aren't nationalizing them. In fact the government has gone out of its way to give banks money without taking control. They've given the banks over $240 billion, including 45 billion to Citibank alone. But the government structured the deal in a special way, specifically designed so it was not a nationalization. And this week, when Citibank's troubles got worse, the government had to go through these amazing contortions to help the bank without becoming its owner. Because the government, and all of them, from President Bush and Henry Paulson, to President Obama and Tim Geitner and Ben Bernanke, they all say the same thing. They don't want the government owning banks.

Adam Davidson: Now, Alex, I always think that there is another option. The government could just let the banking system sort things out on its own. If banks made bad bets, then they go out of business. It's not our problem.

Alex Blumberg: Well, the Federal Reserve Chairman, Ben Bernanke, dismissed this option when he told Congress in a private briefing, it actually is our problem. He was quoted as saying, if we let the banking system fail, no one will talk about the Great Depression anymore, because this will be so much worse. So, we need banks, which, Columbia Business School Professor David Beim says, is why governments always protect them.

> David Beim: The year 37, in Ancient Rome, there was a bank run. They had a very sophisticated banking system, and there was run on those banks in AD 37. Some number of ships didn't come in with their cargo, or something happened, and the Emperor went out of Rome, and how did he deal with it? He did just what Ben Bernanke would do. He came galloping back into Rome with bags full of coin and distributed them to the banks. It's been happening as long as there have been banks. Governments must protect banks.

Adam Davidson: So if the government won't let banks fail, and also won't take them over, that means that Citibank, Bank of America, throw in JP Morgan Chase and three or four others--they have us over a barrel. We can't let them just fail. And it's going to cost us one way or another to keep them alive. And this sucks. I feel that, you feel that, Congress definitely feels that.

Alex Blumberg: Or at least their constituents are communicating those feelings to Congress. And this frustration leads to a lot of lashing out about almost exactly the wrong thing. Here's Massachusetts congressman Mike Capuano yelling at the banks.

> Mike Capuano: Start loaning the money that we gave you. Get it on the street.

Alex Blumberg: This might be a reasonable expectation for healthy banks, but for insolvent banks it can be a disaster, and the reason all goes back to our balance sheet. When a bank is insolvent, it doesn't have enough capital to cover its losses. In that situation, banks would actually be doing the RIGHT thing by keeping the bailout money that we're giving them. It needs to hold onto their capital, that's how they fix their balance sheets. If they loaned the money away, they'd be returning to the situation we're trying to rescue them from. In other words, saving the banking system, means that the banks that are worst off, should loan less, not more. But beyond the balance sheet, David Beim has a much more profound reason why banks shouldn't lend. He shows me something on his computer.

David Beim: Ok, so here is a picture, a graphic, and a chart that goes back to 1916 and up to...

Alex Blumberg: We're in his office, and we're looking at a graph, and it's, basically, a measure of how much debt we the citizens of America, are in. How much we all owe--on our mortgages and credit cards and auto loans--compared to the economy as a whole, the GDP. And for most of history, the amount we owed was a lot smaller than the economy as a whole. This ratio, household debt to GDP bounces along around between 30 and 50 percent, for most of the '30s and '40s 50s, 60s, and 70s, right into the 80s. Then it breaks through 50 % in the 80s, starts heading up in the 1990s. And then ..

David Beim: From 2000 to 2008, it just goes, almost a hockey stick, it goes dramatically upward.

Alex Blumberg: Like a rocket.

David Beim: It hits 100% of GDP. That is to say, currently, consumers own 13 trillion dollars when the GDP is $13 trillion. That's a $100 trillion owed by individuals. That is a ton.

Alex Blumberg: I'm going to ask a leading question, because I'm looking at a graph right here. Tell me professor, has there ever been a time where we owed that much before?

David Beim: I'm glad you asked me that. And guess what? The earlier peak, which is way over on the left part of the chart, where debt is 100% of GDP, was in 1929. This is a map of twin peaks. One in 1929 and one in 2007.

Alex Blumberg: Does that chart scare you?

David Beim: Yes. That chart is the most striking piece of evidence that I have that what is happening to us is something that goes way beyond toxic assets in banks, it's something that had little to do with mortgage securitization, or ethics on Wall Street, or anything else. It says the problem is us. The problem is not the banks, greedy though they may be, overpaid though they may be. The problem is us. We have over-borrowed. We have been living very high on the hog. We are, our standard of living has been rising dramatically over the last 25 years, and we have been borrowing to make much of that prosperity happen.

Alex Blumberg: And so, when you see Congress, sort of saying we need more, we need to make sure there are strings attached to this money, to make sure the banks are lending it out, that doesn't make any sense.

David Beim: It makes, not only no sense, it makes reverse sense. It's nonsense. Because what the banks have done is already lend too much. The name of this problem is too much debt. We have over-borrowed, and we have done that over many, many decades. And now it's reached just an unbearable peak where people on average cannot repay the debts they've got. In the face of that, it is no solution to try to lend more.

Adam Davidson: All right. So, Alex, our little radio drama is over. We've laughed a little...

Alex Blumberg:...cried a little.

Adam Davidson: And we hope now, that you will be able to understand the news.

Alex Blumberg: And let's just talk here at the end about what the government is actually doing this week.

Adam Davidson: It's been a pretty dramatic week. On Wednesday, the government revealed the details of its plan to save the banks. Now, remember, there are people out there who are saying the government has to act quickly to acknowledge the problems on bank balance sheets, declare insolvent banks insolvent, and step in aggressively to fix it all. One person who believes that, is Simon Johnson, that former IMF official...

Simon Johnson: Yes, I think there's a level of deceit here. Right, I'm part of the banks, and I think the government is going along with it far too much. One of my colleagues, nicely articulated what should have been the principle, now, which is "No New Lies." Right? The balance sheet, of these banks is as far as we know, a huge lie. Right? They don't want to show you, or tell themselves what this stuff is really worth. And we're saying, deal with it now, deal with it seriously, deal with the problems in the banking system openly. Or, there will be hell to pay

Adam Davidson: Simon Johnson says every day we delay taking over insolvent banks, the economy gets weaker and the solution gets more difficult. Well, according to the plan, the Obama administration revealed this week, they have a different view, and they think it's best to go about things more deliberately. They announced on Wednesday, they're going to take two months to figure out how healthy the banks are, that's the stress test you've heard a lot about, and another 6 months to give some money to the banks that need it. And they've said, to the media, and to Congress, that they're pretty sure that they know what those stress tests are going to find: that America's biggest banks are healthy. The government will never need to take them over.

Alex Blumberg: In other words, given a choice between a scary, and unprecedented, for this country at least, takeover of the banks immediately, and much smaller measures where they keep the banks afloat, don't challenge them too much on the truthfulness of their balance sheets, and hope that in time, things will sort themselves out, they're going with time. But their public statements did leave them plenty of wiggle room. And of course ... if they WERE planning to take over the banking system ... they wouldn't announce it beforehand. They'd probably say exactly what they're saying right now ... wait till everything's set up ... till they hired enough people and got all their plans in order ... and then one Friday evening, they'd make an announcement, and nationalize the banks over the weekend.

Ira Glass: Alex Blumberg and Adam Davidson. In addition to their radio jobs, they do a blog and a podcast three times a week, where they explain the latest economic news in normal language that anybody can understand. This is the Planet Money podcast. It's at NPR.org/money. Coming up after the break, we go on a field trip to visit a toxic asset in its natural environment, which in this case turns out to be suburban New Jersey. That's in a minute from Chicago Public Radio and Public Radio International when our program continues.

[BREAK]

Ira Glass: It’s This American Life, I’m Ira Glass. We’ve arrived at Act 2 of our show, Act 2, Clean- up Squad. Well as we heard earlier in today’s program, in the end, solving the banking crisis means that somebody is just going have to have to buy up these toxic assets: the stuff that is poisoning bank balance sheets and making them insolvent. And one of the main principles behind the Obama Administration strategy, is that they are trying to get private investors to do as much of this buying up as possible. So the administration has created all kinds of incentives and guarantees for investors to do just that. But private investors are also stepping in to buy toxic assets all over the country in much smaller ways. And to understand this, take the simplest toxic asset there is ... a home mortgage ... where the homeowners can't make their payments and are in foreclosure or they are near foreclosure. There are guys buying up those mortgages, basically takes the mortgage off your hands. Now imagine for a second if that happened to you, if that happened to you, and your mortgage, one of these guys would now, basically be just like the bank, as far as you were concerned. If you defaulted, that guy would get your house. If you wanted to renegotiate the terms of your mortgage so you don't default, you would do it with him. Well, Reporter Lisa Chow went out with a couple of these businessmen.

Lisa Chow: The first time I meet the guys who actually want more toxic assets in their lives, is in a diner in New Jersey. Raj Bhatia is sitting at a corner booth, with two other guys.

> Raj Bhatia: My fellow Ivy League MBAs think I'm nuts. Cause I'm going to get dirty now.

Lisa Chow: Raj graduated from Columbia Business School in the mid-90s, and for years he ran a hedge fund. And by getting dirty he means, he's actually going to be getting out in the world, instead of sitting behind a desk. He's convinced he can make money buying home mortgages that aren’t being paid back. Raj has teamed up with Albert Behin to buy pools of these mortgages.

> Albert Behin: And we got together and basically said you know there's going to be tremendous opportunities buying some of this residential debt that I basically helped create over the past 6, 7, 8 years. Albert started selling mortgages in 2000, just as housing prices began to skyrocket ... and saw a lot of the abuses and terrible lending practices. He steered clear of most of that. And now, as those mortgages are starting to go bad, Albert and Raj are looking to buy them up at a discount, and they’re meeting in diners like these, with potential investors like this guy, [Benek Oster,] who's made millions in finance over the years.

Benek Oster: Hypothetically, I've got $5 million I'd like to put in. How much you buying, how many loans are you getting for $5 million?

Albert Behin: I'm going to make it very easy for you. Average loan is $350,000...

Lisa Chow: I'm in a car with Raj, Albert and This American Life producer Alex Blumberg. We're driving 20 miles outside Manhattan to a town in New Jersey, called Wayne. The business pitch at the diner worked. Albert and Raj have a couple of investors at this point, and they're getting ready to buy some mortgages. Here's how it works. Banks have given lots and lots of mortgages to people who've stopped paying. To get them off their books, they've sold them off at a huge discounts, and they do it in massive numbers, thousands of mortgages at a time, to hedge funds and other large investment funds. These funds are sometimes called vulture funds. They don't actually want to keep these mortgages. They just want to buy from the banks low, mark up the price a little, and sell to guys like Albert and Raj for a profit. Which is why we're on this trip. Albert and Raj are thinking of buying the mortgages for 40 houses from one of these funds, all homes in New Jersey, and they want to go see what they're buying. They've made more than a dozen of these trips so far to look at different homes. And sometimes it feels a little weird, like they're spying or something.

Albert Behin: I'll tell you a story. One of the first times Raj came out to see houses. I went out a couple of times already, and we're just snapping a picture of the subject property and Raj is like, there's a cop. We're not doing anything wrong. We're just snapping a picture of a house. Relax there.

Raj Bhatia: I'm not cut out for fieldwork.

Alex Blumberg: So this is totally new for you Raj.

Albert Behin: This is new for everybody I mean.

Raj Bhatia: Yes, big funds have bought a lot of product but to actually go home to home and re-price the mortgages and talk to homeowners and acquire the product and resell the product and reposition the loans, this is all very, very new.

Lisa Chow: Raj and Albert know certain things about this group of loans. They know that 90 percent of the houses are in foreclosure. They know the balances on all the mortgages, when the borrowers stopped making payments. They know what the borrowers claimed in income on their original loan documents; although they also know enough not to believe those numbers too strongly. But there are lots of things the mortgage documents can't tell you. For instance, Albert and Raj don't even know if someone's living in the house they're about to go look at. New Jersey's unusually slow to kick someone out of a house. Even on loans that are 15 months delinquent, people can still be there, waiting to be evicted. And they want to know other things. How does the neighborhood feel? And so far, this neighborhood feels good.

> Raj Bhatia: Ok, nice neighborhood. You can imagine what this looks like in the summertime with all the canopy of trees. It's an established area. I'm really impressed with this. This is great.

Lisa Chow: And Albert notices another good sign:

> Albert Behin: There's really no for-sale signs out there. This is great. I have not seen a for-sale sign. You'll see one or two coming up; I'm sure but not yet.

Lisa Chow: Which means, the market's not glutted. If they take over the house, they can sell it. And that's another thing they're doing -looking at how houses similar to the ones in their pool, have sold recently. We drive up to one house on a corner that recently got bought. Albert pulls out a digital camera and takes a photo.

> Albert Behin: Ok, run, run, run, and go. I'm kidding.

Lisa Chow: Then we drive a quarter of a mile to the house whose mortgage Albert and Raj are looking to own.

[Car noise... (You have reached the destination.)]

> Raj Bhatia: OK, that's it on the right hand side.

Lisa Chow: Raj parks the car. The house is a red, old-style colonial on a suburban street. Albert notices that there are little stickers in the window alerting firefighters that children live here. The lawn is well-manicured, there's a fenced-in backyard. According to Albert's paperwork, the house's appraised value, back in the fall of 2007, was $635,000 dollars. Now it's down to $440,000, which is pretty bad, if you consider that what they owe on the house is 475 thousand. They're underwater. They owe more than their house is worth. And, they haven't made a mortgage payment in 16 months, since October of 2007. But you'd never know by looking at it.

> Albert Behin: We can see that there are kids there. There are obviously kids there. This is a neighborhood where you grow up a family. There's a backyard.

This house is in generally good condition. You can definitely tell that someone still lives here. Some of the houses, no one lives in at all.

Lisa Chow: The loan documents don't tell you any of that. Albert and Raj are not actually allowed, by law, to talk to the people living here. And in fact, the better deal Raj and Albert get, the better it might be for the homeowner. Raj explains it this way. Say the mortgage is worth $400,000, but they get it at $200,000, they can approach the homeowner and say, we can cut you a new deal, rewrite your mortgage. And then, for the homeowner ...

Raj Bhatia: the numbers are very different. Their monthly payments can go down from1300 to 500 a month. And we're making an incredibly good return on our money.

Alex Blumberg: And you can do that because you've bought it at such a good discount.

Raj Bhatia: It's really not, it's not that we're doing really rocket science finance. I bought the mortgage at a reduction, and someone has taken a hit on that, and we have the ability to restructure that mortgage now.

Lisa Chow: But Albert says so far, in their experience, even with this kind of reduction, 3/4's of the homeowners can't afford to make the payments. So Raj says there's a second option...

Raj Bhatia: If they absolutely can't do something, you proceed with the foreclosure and right now we're in discussions to rent back the home to the homeowners, where they live there, they stay there, but they're renting the home now. They don't own it. It's a relief, in a certain way.

Lisa Chow: To understand that relief, imagine the family in this house. They owe about $475,000 to the bank. Since the house is worth $440,000, even after they sold it, they'd still owe the bank 35 thousand. Albert and Raj would let them stay in the house, rent the house at reduced rent, and they'd wipe out all that debt. For Albert and Raj this a business, they aren't doing this out of the kindness of their hearts. They want to make money. They're buying homes in the process of foreclosure. That process can draw out for months, which can be costly to Albert and Raj if the occupants aren't paying anything. So if Albert and Raj can't sell the house to the occupants for a lower price or get them to rent, they at least want them out. And in that situation, Raj has a simple pitch to the homeowners.

Raj Bhatia: Why don't we help you by writing a check $5- to $7,000 dollars, every home's different, depending on percentages, and we'll help you move, and you just give us the keys and we'll take over the home.

Lisa Chow: Albert and Raj have already brokered a couple of pools of mortgages for other investors. Raj says the best-case scenario is the homeowners are willing to talk and renegotiate the loan.

> Raj Bhatia: Worse case scenario, really isn't worst-case. It's that we're not getting any communication from the homeowner. We try to call, we try to send letters, we really haven't encountered a homeowner coming out with a shotgun and saying get off my property.
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> Alex Blumberg: It strikes me though, looking at what you guys are doing, right now, if this works, you buy this pool, you get the house price to what it needs to be, and you get the homeowner into either a mortgage they can afford, or they're able to rent it, or you pay them a bit to move somewhere else. It's not great. Nothing in this process is great. But it actually sounds like what we're talking about here is a free-market solution to the problem. Right or not?
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> Albert Behin: But I don't think this alone will. I think there's got to be some sort of government help, along with this.
>
> Alex Blumberg: But why is that, you did this without government help, or did you not?
>
> Raj Bhatia: I'll tell you why. It's a simple answer. There are not enough of us out there to absorb what's out there. I other words, if we had unlimited funds, if Mortgage Strategies had unlimited funds...
>
> Alex Blumberg: That's the name of your company...
>
> Raj Bhatia: That's the name of the company...we could ramp up very quickly, and we could be putting away hundreds of millions of dollars of this type of product, and we're working through it, I mean we could do that, we would have a staff and we'd be out there and we'd do it. That would maybe make a little bit of a dent here in the New York Metro Area. But, you got to remember, there's
> trillions of dollars of in product out there...
>
> Albert Behin: No, no. There's even a bigger issue. And that's What we're seeing is that a lot of banks don't want to get rid of this product because, I think, they can't afford to get rid of it at the prices that the market is saying, this is market.
>
> Alex Blumberg: In other words if they sell you these pools of loans at the

prices you need to be able to make money and actually do the work you're doing here, they'd go bankrupt.

Albert Behin: Yeah, they'd be insolvent. Yes, I think so. That's exactly what I'm saying.

Lisa Chow: Here's another problem. Albert and Raj, as hard as they're working and as complicated as it seems, are actually dealing with the simplest assets out there: simple home loans, between a bank and a person. They're not dealing in the complex world of mortgage-backed securities, where mortgages were bundled, sliced and sold to thousands of investors, and where it's difficult to trace ownership and almost impossible to figure out what you're actually buying and who you're buying it from. They're not dealing in any of the exotic financial instruments like collateralized debt obligations. Essentially, Albert and Raj are buying the least toxic of the toxic assets on banks' balance sheets. Now, we just need someone to buy the rest.

Ira Glass: Lisa Chow is a reporter for public radio station WNYC in New York.

Ira Glass: Well, our program was produced today by Alex Blumberg and me, with Jane Feltes, Sarah Koenig, Lisa Pollack, Robyn Semien, Alyssa Schipp, and Nancy Updike. Jonathan Kern helped edit today's show. Our senior producer is Julie Snyder. Production help from Andi Dixon. Seth Lind is our Production Manager. Special thanks today to Caitlin Kenney, to Ellen Weiss, John Guardo, Manoli Weatherall, Laura Connaway, Isaac Baker, Jo Christanet, Ashwani Kaul, Radio Lab's Robert Krulwich, and Jad Abermod, who Adam and Alex freely admit they are ripping off in their co-hosting style. To Greg Berman, Donald Heath, and a special shout-out to James Quack. Our website, www.thisamericanlife,org. This American Life is distributed by Public Radio International. WBEZ Management oversight by our boss, Mr. Torey Malatia, who's just back from the G7 Economic Meeting in Rome. You know, he actually crashed it. He burst into the meetings, and demanded that he be included, not in the sessions but in the delicious snacks that they serve between the sessions. And he had a threat.

TAPE: That sure is a nice global economy you have there, be a shame if anything happened to it.

IRA: I'm Ira Glass. Back next week with more stories of This American Life.