

US public-private fund

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Henry Ford mused: "Coming together is a beginning. Keeping together is progress. Working together is success." All three can prove fraught. The US government, under Treasury secretary Tim Geithner's plans, must unite the public and private sectors in pursuit of a common goal: to free bank balance sheets of noxious assets and finally establish market pricing.

To do so, the public-private investment fund, initially \$500bn, must overcome headaches that stymied previous schemes. Asset heterogeneity and vast value uncertainty complicated bringing together banks hoping to resist further losses with the government intent on taxpayer protection. The key, suggests Harvard professor Lucian Bebchuk, is to have a significant number of private funds dedicated to buying and managing assets, rather than one large fund. With low-cost, non-recourse public funding, multiple buyers would create price tension, while retaining a strong incentive not to overpay.

A further question is how best to determine the level of public financing. Here the authorities have some pseudo pricing power. Greater leverage would lessen the private sector's downside and make for more aggressive bidding. That might reduce systemic losses but avoiding overspending is also key. Here, Prof Bebchuk suggests an auction, with aspiring managers bidding based on the maximum equity they would commit. The Treasury sets public participation at the lowest level possible consistent with achieving its target fund size. Two issues, however, remain.

First, values unearthed may remain low enough to wipe out banks' slim capital cushions. Just one deal would help ungun markets. But banks unwilling to sell can use asset heterogeneity to resist comparisons.

Second, let's assume the best: assets change hands above distressed valuations but below fundamental value. Significant upside beckons for private participants. That raises the prospect of political ire at the public sector's meagre return on its debt by those unwilling to extend public risk-taking now. So be it. No one ever said compromise was easy.

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