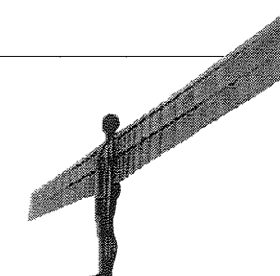


Opinion

The Angel of the South will make us go wow

Melanie Reid, page 28



Radical surgery is required to save this patient

Unless governments stop posturing for the sake of headlines, the full nationalisation of every bank is inevitable

Anatole Kaletsky



If a minor flesh wound becomes infected and is allowed to fester, it can turn to gangrene and lead to crippling amputation or death. This is the situation of the world economy today.

What started as a minor flesh wound — the US sub-prime mortgage crisis of August 2007 — could easily have been cured if regulators, governments and central banks had taken decisive action a year ago, when it was already obvious that this was a problem that private financial markets could not resolve. But instead of taking action — guaranteeing and recapitalising banks, buying-up distressed mortgages and slashing interest rates to zero — governments all over the world essentially crossed their fingers and hoped for the best.

So the wound continued to fester and a year later became full-scale gangrene with the bankruptcy of Lehman Brothers on September 15. That fateful date is almost five months ago and the gangrene is still spreading, while the politicians who could cure it stand around and talk.

This week the talk of a cure was supposed to turn to action. The Obama Administration was expected to announce a comprehensive package to stabilise the US banking system once and for all. The Bank of England was supposed to convince the public that it had finally got the

measure of the recession and had the tools to prevent a total collapse in the economy. And Gordon Brown was meant to show tangible results from the hundreds of billions invested in British bank rescues, as the new managements of these dysfunctional organisations committed themselves publicly to start financing the economy instead of just lining their own pockets.

Tragically, however, none of these things has happened. The much vaunted “comprehensive plan” announced on Tuesday by the new US Treasury Secretary, Timothy Geithner, turned out to be nothing but a vague holding statement. The Bank of England’s talk of “unconventional methods” lacked the sense of urgency implied by its own cataclysmic forecasts. And in Britain, government action on the banks focused on frivolous headlines about bonuses and personal apologies, while long-promised commitments to increase credit to businesses, homeowners and consumers kept receding, mirage-like, as they have throughout the past five months.

Have we now reached the point where full-scale amputation is the only cure for the potentially fatal financial gangrene? Maybe the only way to avoid a truly catastrophic global depression and trade war is to nationalise every significant bank in America, Britain and the eurozone — since none could survive without government guarantees.

Many economists now take this view. The bitter disappointment over Mr Geithner’s announcement, which sent share prices on Wall Street crashing back towards the lows they hit just before Barack Obama’s election, now threatens to turn this

desperation into a majority view.

I am not yet quite ready to join this growing consensus. For me, dismantling global financial capitalism and replacing it with a neo-Marxist system of capital allocation by the State is too big a mental leap. But the way things are moving, even I will soon capitulate to the inevitability of universal bank nationalisation. The reason is simple.

As the Governor of the Bank of England explained yesterday, neither zero interest rates nor tax cuts can revive economic activity if the credit system remains paralysed. Our politicians and bankers face a simple choice: either normal private banking services are restored quickly or governments take direct control.

I fervently hope that leading Western economies can still choose the former course. But we are losing a race against time. Mr Brown’s five-point plan for stabilising the banking system made a lot of sense when it was announced in early January. But since then almost nothing has happened and credit has continued imploding.

The situation in America is even more alarming. Mr Geithner’s announcement this week was almost as ill prepared and sketchy as the letter from Henry Paulson, his predecessor, demanding a blank cheque for \$700 billion from Congress. Mr Geithner’s proposals suggested that he has no real idea what to do. If the US Government has run out of options, nationalising all leading banks is the only logical solution and the sooner the better.

But before jumping to this conclusion it is worth asking why financial policy has been so ineffective. After all, the policies



Timothy Geithner’s “vague holding statement” sent shares tumbling

needed to save the private banking system are obvious: stronger deposit guarantees; government insurance for toxic assets and against catastrophic credit losses; partial forgiveness of mortgage loans; binding commitments on lending to non-financial borrowers.

Why, then, have these proved impossible to implement? Until this week I assumed the main reason was incompetence or ideological myopia. But this week’s feeble performance by Mr Geithner, along with the frenzy over bankers’ bonuses in Britain, suggests a different, and perhaps less intractable, problem.

Reports from Washington suggest that the fears about appearing “soft” on the banks was what prevented Mr Geithner making any serious

announcements this week. Similar anxieties about “how it will look in the headlines” appear to be delaying the British Government’s decisions on insurance for toxic assets, which have been months in gestation. If this is true, then British and US leaders could yet break out of this self-destructive populism by explaining two simple facts.

First, the public must be made to understand that “punishing” or “bailing out” banks is not the same as punishing or bailing out bankers. Voters hate bankers for lending money so stupidly, but they should remember whose money the bankers lent. If banks were allowed to collapse, then most of the losses would fall on the small depositors whose money the bankers were lending — or on taxpayers who would stump up the cash to guarantee those bank deposits. If the Government supports or subsidises a bank, it is subsidising depositors, not shareholders or bankers.

This leads to the second, more important, point. Whatever money the Government may lose in buying toxic loans or offering banks subsidised insurance pales into insignificance compared with the tax revenues lost to the Treasury if the economy falls into deep recession. Even if taxpayers were to “lose” tens of billions subsidising banking systems, this would be money well spent if it accelerated recovery even by a few months.

For politicians and the media to endanger the entire structure of financial capitalism for the sake of a few populist headlines is the height of irresponsibility. Cut the bankers down to size by all means, but let’s not amputate the banks.