Bank nationalisation gains ground with Republicans

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Long regarded in the US as a folly of Europeans, nationalisation is gaining rapid acceptance among Washington opinion-formers – and not just with Alan Greenspan, former Federal Reserve chairman. Perhaps stranger still, many of those talking about nationalising banks are Republicans.

Lindsey Graham, the Republican senator for South Carolina, says that many of his colleagues, including John McCain, the defeated presidential candidate, agree with his view that nationalisation of some banks should be “on the table”.

Mr Graham says that people across the US accept his argument that it is untenable to keep throwing good money after bad into institutions such as Citigroup and Bank of America, which now have a lower net value than the amount of public funds they have received.

“You should not get caught up on a word [nationalisation],” he told the Financial Times in an interview. “I would argue that we cannot be ideologically a little bit pregnant. It doesn’t matter what you call it, but we can’t keep on funding these zombie banks [without gaining public control]. That’s what the Japanese did.”

Barack Obama, the president, who has tried to avoid panicking lawmakers and markets by entertaining the idea, has moved more towards what he calls the “Swedish model” – an approach backed strongly by Mr Graham. In the early 1990s Sweden nationalised its banking sector then auctioned banks having cleaned up balance sheets. “In limited circumstances the Swedish model makes sense for the US,” says Mr Graham.

Mr Obama last weekend made clear he was leaning more towards the Swedish model than to the piecemeal approach taken in Japan, which many would argue is the direction US public policy appears to be heading.

“They [the Japanese] sort of papered things over,” Mr Obama said. “They never really bit the bullet . . . and so you never got credit flowing the way it should have, and the bad assets in their system just corroded the economy for a long period of time.”

Administration officials acknowledge that the rescue plan unveiled by Tim Geithner, Treasury secretary, last week could result in the temporary nationalisation of some weak banks.

The plan sets out a framework for revealing the extent of the likely credit losses facing banks. Most private sector analysts believe the exercise will reveal that some banks have large capital shortfalls.

Policymakers acknowledge that if this is indeed the case, it will be difficult for those with the largest shortfalls to raise the required equity from the markets, in which case the government would probably have to take temporary control. Moreover, while nationalisation remains taboo in some political circles it is increasingly openly discussed among past and present economic policymakers of all leanings.

“In this country nationalisation of some banks – not the whole banking sector – should be a last resort, but it should definitely now be on the table,” said David Walker, president of the Peterson Foundation and a former senior official in the George W. Bush administration.

The time for biting the bullet may also be fast approaching.

In early April, big institutions will publish their first-quarter results. If the intervening Treasury stress tests have not by then revealed the true state of their balance sheets, then their first-quarter results may do so.

“The first week in April – that’s when the children’s party is over,” says Chris Whalen, co-founder of Institutional Risk Analytics. “That is when the obvious will become apparent.”

The Obama administration remains opposed to federal control. Mr Geithner last week said: “Governments are terrible managers of bad assets.”

Others say he may eventually face no choice. “The danger we face is a Freddie Mac/Fannie Mae scenario where government gives the banking sector guarantees and then socialises the losses,” says Adam Posen, an economist. “That’s the worst thing we could do.”