The Many Faces of Bank Nationalization

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Calls for nationalizing the banking industry have been bubbling since at least last September 2008, when the current Banking Panic began in the wake of the Lehman Brothers bank collapse, the initial AIG bailout, and the quick absorption of Merrill Lynch-Wachovia-Washington Mutual banks by their larger competitors, Bank of America, Wells Fargo, and JP Morgan Chase.

One of the first to raise the idea of the possible need for bank nationalization last fall were the editorialists from the Wall St. Journal, as well as ex-Federal Reserve chairman, Alan Greenspan. Of course, what the Journal's editorialists and Greenspan meant by their idea of nationalization was the government should assume responsibility for cleaning up a bank's bad assets at taxpayer expense, followed by the government quickly selling off the best of the bank's remaining assets at firesale prices to new investors. The 'nationalized' bank would subsequently and promptly reopen for business in short order once again as a completely private institution, its 'bills' (bad assets) having been paid for by the taxpayer in the interim.

Nationalization is thus merely a kind of ad hoc bankruptcy proceeding declared and set in motion by the US government. The banks would not be 'taken over' in anything but a legal, formal sense. A quick transfer of bad assets follows, after which the institution is 'spun off' again and sold to private investors. Nationalization in this sense functions merely a tactical move for removing bad assets and resurrecting a zombie bank from the dead.

Something quite similar to this was in fact what occurred with the failure of the mid-sized regional bank, IndyMac, in late summer 2008. It was taken over by the U.S. government agency, the Federal Deposit Insurance Corporation, or FDIC. Today IndyMac has reopened expunged of its bad debts, which are now debts of the government and taxpayer. In fact, the same group of investors who once owned IndyMac have rebought it once again, at firesale prices, from the FDIC. They are the owners once again. The investors were 'rescued'. Nationalization is thus a form of 'investor rescue', a kind of 'temporary trusteeship' in a formal, legal sense pending reprivatization.

What the Journal and Greenspan meant by bank nationalization is simply let's 'do and IndyMac' for other, even bigger banks. There's no idea implied that a bank might be more permanently taken over and operated on a day to day basis, not for the interests of private investors but for the broader public interest of the nation and all its inhabitants.

Since last fall 2008, when the bankers essentially went on strike in terms of refusing to lend to businesses and consumers except at all but the most usurous rates, debate has raged in ruling class circles as to what to do with the trillions of 'bad assets' on banks' balance sheets. These 'bad assets' in the form of both 'bad loans' and 'bad securities' now amount to somewhere between $4 and $6 trillion, according to various sources such as Fortune Magazine, the Journal, reputable independent sources, such as NY University Professor, Nouriel Roubini, and even Treasury Secretary Geithner prior to his appointment in that official role. The central argument is that until the 'bad assets' are somehow relieved from the banks' balance sheets, banks will continue to refuse to lend and the accelerating current decline in the real economy in the U.S. will continue to worsen.

The Journal-Greenspan notion of bank nationalization must be viewed as part of that ongoing capitalist class debate. Nationalization is merely a tactic for addressing bad asset removal and subsequent quick reprivatization, nothing more.

Other tactical proposals have contended since last fall with the idea of bank nationalization as 'temporary trusteeship' and means to remove bad assets. They include proposals such as creating an 'Aggregator Bad Bank', into which the government would deposit the banks' bad assets' after somehow purchasing them. But 'purchasing' has proved difficult since banks have actually refused to sell the bad assets. Banks have been 'on strike' since last fall, in other words, not only in terms of 'refusing to lend' but in terms of 'refusing to sell' bad assets as well.

Bad assets on banks' books take two forms. One is 'bad loans' assets. Another is 'bad securitized' assets. According to legal accounting rules, banks can hold 'bad loans' on their books at their initial purchased values. Hence, they have little incentive to sell them at lower values and have to write-down the loss. But who wants to buy the loans at top dollar when it is clear they are worth far less than the banks are willing to sell them? Thus, no other investors have wanted to purchase the bad loans way above their market value since last September. And should the government do so it would mean a clear subsidization of the banks at taxpayer expense. So the 'bad loans' have not moved off the banks' books. Something similar has been the case with the 'bad securitized' assets since last fall. These are the subprime mortgages, auto loans, credit cards, student loans and various other asset backed securities that have been 'securitized', or bundled, into new financial instruments for sale since 2002. Unlike 'bad loans', securitized bad assets must be valued at their true, virtually worthless, prices today. That means close to zero. While banks would like to sell these assets (to investors or government), they want to sell them only above their true 'mark to market' values. Investors, in turn, want only to buy them at their true, virtually worthless price—if at all. Some are considered so worthless, no one has stepped up to buy them. So, once again, the 'bad assets' in this form are not sold and remain 'toxic' on banks' balance sheets, worsening with the passage of each day.

What is described in the preceding paragraph is the 'grand dilemma' faced by the financial system today. The US government, Treasury and Federal Reserve, have been trying various ways to expunge and rid the banks of the bad assets, without success to date. The banks in the meantime remain on strike and refuse to lend (or to sell the assets).

The aforementioned 'Aggregator Bank' is one idea for trying to rid the banks of their bad assets. Something like it was tried in Sweden in the early 1990s with success. However, that was one small country. The problem is many times more immense in the US (and globally) today. The Swedish government could successfully 'buy up' the bad assets and place them in the 'Aggregator' bank. The amounts to be 'bought up' today, however, are likely greater than any one government can finance, including the U.S. It has sometimes been said that the Swedish government 'nationalized' its banks in the process of setting up its 'Bad Bank Aggregator'. But, once again, that idea of nationalization is simply a variation on the theme proposed by the Wall St. Journal and Greenspan.

Other variations on the theme that have also been confused with 'nationalization' have been efforts by the US Treasury and Federal Reserve to buy stock in the failing banks—whether in the form of preferred stock purchases, common stock, or some convertible arrangements combining both common and preferred. Instead of buying up the balance of the bad assets altogether (e.g. Aggregator bank), the idea here is to offset the bad assets on the banks' books with the hope that, once the assets are neutralized, the banks will begin to lend again. Stock ownership, partial or even majority, is thus also identified with the idea of nationalization.

Thus last fall the Fed and Treasury bought 80% of the stock of AIG and therefore somehow effectively 'nationalized' it. But formal stock ownership is in no way equivalent to nationalization. To recall, AIG simply went on to act as it always had, throwing billion dollar parties for its managers and doling out huge sums of TARP money in bonuses. If there is any example of the limits of legal ownership definitions of nationalization, one need look no further than the experience of AIG.

The TARP program introduced last October was an attempt to generalize the AIG action. But at $700 billion it was soon apparent TARP was a drop in the bucket needed the $4-$6 trillion hole in bank balance sheets. Amazingly, what the TARP experiment shows is that the US government had no idea of the magnitude of the banks' losses and how effectively the banks had hid that magnitude from the public and government itself. The TARP program quickly ran into the aforementioned problem of banks' refusing to sell at anything but inflated, above-market prices for their bad assets. Then Secretary of Treasury Paulson panicked Congress and the public to give him the $700 billion, only to find it was a grossly insufficient amount and that, in any event, the banks refused to sell their bad assets unless massively subsidized by the government to do so.

When Citigroup and Bank of America collapsed in November 2008 the Treasury and Fed threw much of what remained of TARP funds at them (and more for AIG as well), and came up with hundreds of billions more in guarantees against their losses ($300 billion alone for Citigroup) from the Fed as stopgap measures. But Citigroup and Bank of America fell still further into a hole in January-February 2009, requiring still more bailout. By February it was becoming increasingly clear that that cumulative balance sheet hole in the big 19 banks continued to grow daily. At $4 to $6 trillion it was becoming increasingly unlikely even the US government could afford to buy all the bad assets on banks' balance sheets on its own.

This re-ignited once again the discussion and debate on bank nationalization this past February. If the US government itself can't afford to buy all the bad assets, why throw any taxpayer money at all down 'the black hole' some began to argue? Perhaps the banks were not 'too big to fail'. Perhaps they should be allowed to go under. Or …perhaps the government should nationalize them. But if nationalization defined as bad asset clean up was not possible, what would nationalization now mean?

By early February the call for some kind of nationalization began to emerge from various directions. The AFL-CIO raised it, but provided no definition of what it should mean. Noted economists like nobel laureate, Joseph Stiglitz, called for it, as it NYU professor, Nouriel Roubini, whose predictions of the evolution of the crisis had proved correct for the past two years. James Baker, the main policymaker during the Reagan administration, came out for it. Greenspan reiterated that nationalization was necessary for an 'orderly restructuring' of the system. Key figures in the Republican party, such as Lindsey Graham, declared on public tv "if nationalization is what works, then we should do it", as did Banking Committee chair in the Senate, Democrat Chris Dodd.

But immediately the Obama administration's big guns responded, discouraging the idea and very talk of nationalization. Geithner, White House economic advisor, Larry Summers, and Fed chairman, Ben Bernanke, all quickly debunked the idea, as did House Banking Committee chairman, Barney Frank. Dodd in the Senate backtracked and joined the denial. They sounded off in unison with big bank CEOs, Ken Lewis of Bank of America, and Jaime Dimond of JP Morgan Chase, and Citigroup's Vikram Pandit who declared it 'would be a step backwards'.

The resistance to the very concept itself flowed from yet another scheme in the works by which to have the government and taxpayer subsidize the banks and investors to depart with the 'bad assets' on bank balance sheets. That latest scheme was revealed in early March with details later on what was called the 'Private-Public Investment Program', or PPIP, released by Geithner on March 23. But like TARP before it, PPIP was essentially still a 'bad asset' buy out idea. This time with the twist that somehow those speculator-investors, who created the financial crisis by issuing trillions in 'securitized assets' that went bust, would now come to the rescue of the system and buy up the bad assets—providing, of course, the government generously subsidized the process. That subsidization would be financed, this time with a twist, not only by the Treasury providing funds but by having the Federal Reserve print money to the tune of $ trillions
of dollars more. The government commitment to the banks thus overnight escalated from merely $3-$4 trillion to date to more than double that amount.

But should the newest bailout of banks fail, as it will, the question on the agenda once again is to proceed to some form of nationalization. The debate on nationalization is thus bound to reappear aggressively once more as it becomes clear the Geithner plan is failing.

But when the debate re-emerges anew, it can no longer be limited to its past definitions. Nationalization as mere stock ownership—indeed any kind of formal ownership—has already been attempted and failed. AIG alone is testimony to that fact. Nationalization as temporary trusteeship is clearly insufficient. It doesn't address what's to be done with the bad assets in the trillions that are taken under 'trusteeship'. Nationalization as an Aggregator Bank raises the problem of how to capitalize an entire banking structure that is largely insolvent, which would cost several trillions of dollars to start. FDIC-IndyMac type takeovers raises similar problems. The FDIC cost of the IndyMac takeover was less than $10 billion. Bailing out Citigroup common stockholders alone will cost more than $1 trillion.

At the other end of the political spectrum, from the idea of nationalization as 'bad asset' purchase, is the idea of nationalization undertaken not in the interests of investors but of the nation itself. Who benefits in any nationalization arrangement is what is key. Is it the 'nation at large' or is it private individuals? It is called 'NATIONalization', for that reason. To call it nationalization, while in the service of individual investors, is to appropriate and distort the true meaning of the original term.

Who then is 'the Nation' that is supposed to benefit? There are 114 million households in the U.S. 91 million are households where wage and salary earners each earn $80K a year or less. The wealthiest 5% households, or roughly 5 million or so, earn the vast majority of their income from capital sources (capital gains, dividends, interest, rents, business incomes). The wealthiest 1% earn virtually all income from capital sources. The 91 million—i.e. the working and most of the middle class—are the overwhelming bulk of the nation. But they do not in any credible way benefit from 'nationalization as investor bailouts'. Any true program of nationalization would thus have to show how the 91 million would in fact benefit. And if it can't be shown they benefit, then the program, whatever its structure, simply can't be called nationalization in any sense of the term.

Nor can true nationalization be limited simply to a legal arrangement, however much or what kind of stock (preferred, common, convertible) may or may not be purchased. Mere legal ownership is not nationalization. Nationalization implies control and control directly on behalf of the public interest, not private interests. But 'control' over what and in what form, is the next reasonable question?

There are all kinds and degrees of control. Formal stock ownership arrangements to date have required at most only occasional reporting by the bank in question. Reports and information is not per se control. Nor is vetoeing management decisions represent effective control. AIG and other banks that have taken $hundreds of billions of taxpayer money to date attest to the limits of reports of decisions made by managers representing private investors. Control must also mean more than the government simply 'vetoing' bank management decisions after the fact. Control must mean decision making itself.

But what kind of decisions? Certainly strategic decisions of the banks. And likely an important range of operational decisions as well. But for that, the government must fire all of a nationalized bank's board of directors and appoint new directors, hopefully with labor, community, and other public representation. CEOs and senior management teams must be totally replaced. Second tier, operational decision making must be daily reviewed by the new senior management team. Key divisional and mid-level current managers may be left in place, providing their performance is closely reviewed on a periodic basis. All this is a minimum decision-making structure that accompanies true nationalization.

Opponents of this view of nationalization will argue that it will result, if implemented for one bank, in the collapse of stock prices for remaining banks as other banks shareholders realize their institution may be next in line and dump their stock. But that not need be the case necessarily. In taking over one bank, the government could announce it would guarantee stock prices of other, still private banks at their current levels at minimum. That would set a floor on stock price collapse and stabilize their stock prices.

Another argument of opponents of true nationalization is that the banks are fundamentally sound, only in need of liquidity. While that argument might have fooled people in 2008, it is now abundantly clear to all that the 'big 19' banks as a group are insolvent and not illiquid. 'Too big to fail' is clearly now 'too big to bail'. The nation cannot afford these kind of institutions any longer. They are literally sucking the economic lifeblood from the country.

Still another opponent argument is to point to AIG and Fannie Mae/Freddie Mac and their continued loss of assets. Opponents then use those institutions as examples of the ultimate failure of nationalizations. But AIG and Fannie/Freddie are not examples of nationalization; they are examples of 'failed investorization' and of bungled bailouts.

Another common complaint levied against nationalization is that taking over a bank is too complex. The government does not have the personnel and doesn't know how to run a bank efficiently. In answer to this, one need only argue how could government possibly do any worse than the so-called 'private experts' now running the banks and who have clearly run them into the ground. Today's so-called bank experts have lost more than $5 trillion to date. Who could possibly do worse? By any private capitalist company's standards, these experts should have all been fired long ago and the companies they've destroyed put into chapter 11 reorganization at minimum.

An entirely new banking structure is needed in America. Such a structure is quite possible, moreover. I have described some elements of such a structure in other recent publications. For a start, it could begin with a full nationalization of the residential mortgage markets and small business property markets. A new agency, the Home and Small Business Loan Corporation (HSBLC), based on experiences in the 1930s with the then Home Owners Loan Corporation and the Reconstruction Finance Corp., could not only clean up the current mess but could continue as the primary financial source for lending for all residential mortgages for consumers earning less than $200,000 per year and companies with 50 or less employees. As a second development, the Federal Reserve itself could be fully nationalization, removing it from its current status as partly private bank owned and financed and partly government. A fully nationalized Federal Reserve could then serve as a 'lender of primary resort' to all consumer loan markets—auto, student, and other consumer loans. Its local structure might include local credit unions and HUD offices to interface with the consumer. It is possible to expand on these ideas similarly for other credit markets. In short, there is another structure for banking that is imaginable.

Yes, every economy needs a credit system. The U.S. just doesn't necessarily need the one it now has, which is destroying the real economy and millions of jobs by the month. Another is possible.

It is time therefore to prepare to shift the inevitable debate on bank nationalization that will soon emerge once again to consider other possible structures and arrangements—structures that exist for the purpose of serving the 'NATION' itself and not private investor interests. Structures in which decisions are not made by the private interests in their behalf but by representatives of the public interest on behalf of the public's interest.

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