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Crisis Q&A: What "Bank Nationalization" Means For You

Posted by Heidi N. Moore

It only takes one good bank-stock rout to turn Americans into big believers in government control.

Yesterday's precipitous plummet in shares of Bank of America, PNC Financial, State Street and other financials may have done the job; the controversy of the day centers around "bank nationalization," or giving our government the license to run U.S. banks.

Deal Journal provides a primer on what bank nationalization means to the average taxpayer.

What does bank nationalization mean?

Bank nationalization, in the most practical form, means giving the U.S. government the power to control banks. That could mean taking control of the public shares, to the power to pick and install new management and boards of directors, and set corpotate strategy. The shocks of the credit crisis last fall spurred lawmakers to semi-nationalize the banking sector; nearly 314 institutions have already signed over some of their shares and other securities to the Treasury in return for $350 billion in government aid.

The government has taken a dramatic intermediate step toward nationalization by taking effective control of American International Group, Fannie Mae and Freddie Mac, but leaving some of their shares on the public markets and their management in private hands. Proponents of U.S. bank nationalization now envision a program by which the government would take over only the largest banks, for a short period of time, in order to loosen the ties on lending. The government may also inject more capital into the banks if necessary, but the belief is that the presence of a government overlord acts more as an implied guarantee to soothe customers and prevent assets from going out the door.

Why nationalize banks?

In Western countries, bank nationalization is largely used as an emergency method to prop up banks during tough times, which includes ??a lending to small and medium-sized businesses and restructuring burdensome loans to consumers. It can help big banks avoid immediate insolvencey. Proponents of bank nationalization argue that current government solutions to the financial crisis have failed, in part because lawmakers have committed as much as $8.5 trillion to support programs without seeing a significant difference in the health of banks, public confidence, or an expansion of lending. Many major banks have accepted government funds but have hoarded them to protect against a rainy day or another steep drop in the value of their loans. The government has already provided $40 billion in cash to Bank of America, for instance, and added another $118 billion in support for the bank's troubled debts. At Tuesday's closing price, the entire market value of Bank of America was about $25.5 billion, meaning that the cash and guarantees from the Treasury are worth about six times as much as Bank of America itself.

What is this costing me?

Duke University finance professor Campbell Harvey estimates that every $150 billion government grant is equivalent to a $1000 contribution from every working or employable American taxpayer. Given the $700 billion Troubled Asset Relief Program alone, every working American is providing $4000 to the bailout from his or her own bank account. That would more than double to $8000 if the entire $825 billion Obama stimulus package is thrown in. For many homeowners, that would be several months worth of mortgage payments.

ABOUT THIS BLOG

Deal Journal is an up-to-the-minute take on the deals and deal makers that shape the landscape of Wall Street, including mergers and acquisitions, capital-raising, private equity and bankruptcy. Deal Journal is updated throughout each trading day with exclusive commentary, analysis, data, news flashes and profiles.The Wall Street Journal's Heidi N. Moore is the lead writer, with contributions from other Journal reporters. Send news items, comments and questions to deals@wsj.com.

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Has nationalization ever worked before?

Most experts believe in nationalization only as a temporary measure, partly because of its mixed history of success. In general, banks are under government control for two reasons: either because an administration or regime maintains near-complete control of all businesses, as in China, Russia North Africa and South America, or because there is a severe economic crisis that impels government action, as in the case of Sweden and Indonesia in the 1990s and the United Kingdom in the cases of Northern Rock, Bradford & Bingley and the Royal Bank of Scotland in the fall of 2008. France has nationalized its banking sector, privatized it again by selling it into private hands, and now may be in the process of another wave of nationalization. In the U.S., very few banks have been fully nationalized, although there have been many cases where the government seized a troubled bank to sell its assets or wind down its operations. That was the case during the savings and loan crisis of the 1990s, when the government took over hundreds of banks for one to two years, installed new chief executives and board members, and steered the process of disposing of their assets. It was also the case with IndyMac, which was seized in July and recently sold to a group of private equity firms. Such seizures have been fruitful in returning money to the government, but they do not count as full nationalizations since their purpose is to stop an imminent failure. In addition, seizures tend to wipe out value as consumers abandon a troubled bank, although the impact is far less than it would be in a total bank failure.

How would nationalization affect the other government rescue efforts?

While the government would have to move some of its chess pieces on the board, few experts believe that nationalization would impact existing government guarantee and aid programs, including deposit guarantees from the Federal Deposit Insurance Corp. The FDIC is, however, well-capitalized because it has direct access to Treasury funds.

What are the disadvantages of bank nationalization?

In the United States, the biggest problem for the government would be the sheer impracticality and expense of taking over all 8,000 banks — or even the 314 institutions that described themselves as “banks” in order to receive government funds. The U.S. government would have, at most, the ability to take over only a handful of the most important institutions. As a result, nationalization would not solve the pressing problem of potential bank failures, particularly among small banks. Consumers who have deposits in such banks would still be dependent on the Federal Deposit Insurance Corp. to return their money during a failure. If larger institutions fail, they can also create damaging shockwaves throughout the markets and cause hundreds of millions of dollars in assets to disappear into thin air, as in the case of Lehman Brothers. In addition, there is significant disagreement over the purpose of bank nationalization.

Will bank nationalization end the credit crisis?

Some experts believe it would allow the government to end the credit crisis by taking control over — and opening– the spigot for lending. Opponents, however, argue that the real problem with U.S. banks is their vast supply of undesirable, toxic assets; nationalization would do nothing to solve that problem unless the government also created a megafund or “bad bank” to absorb the troubled assets and remove them from the banks’ books. Opponents of bank nationalization also fear that consumers might run away from banks that don’t have the advantage of explicit government control, which would leave the government playing favorites and the industry as a whole in a shambles.

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hello? what about shareholders that have half of their life savings in bank stocks in 401ks and IRAs, etc?????

Comment by nick - January 21, 2009 at 3:28 pm

bad idea - I already lost 22k on the governement’s seizure of Wamu - they seize some banks and let others survive - ridiculous for shareholders - why doesn’t anyone ever talk about shareholders?

Comment by fred - January 21, 2009 at 3:31 pm
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