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January 26, 2009

NEWS ANALYSIS

Nationalization Gets a New, Serious Look

By [DAVID E. SANGER](#)

WASHINGTON — Only five days into the Obama presidency, members of the new administration and Democratic leaders in Congress are already dancing around one of the most politically delicate questions about the financial bailout: Is the president prepared to nationalize a huge swath of the nation's banking system?

Privately, most members of the Obama economic team concede that the rapid deterioration of the country's biggest banks, notably [Bank of America](#) and [Citigroup](#), is bound to require far larger investments of taxpayer money, atop the more than \$300 billion of taxpayer money already poured into those two financial institutions and hundreds of others.

But if hundreds of billions of dollars of new investment is needed to shore up those banks, and perhaps their competitors, what do taxpayers get in return? And how do the risks escalate as government's role expands from a few bailouts to control over a vast portion of the financial sector of the world's largest economy?

The Obama administration is making only glancing references to those questions. In an interview Sunday on "This Week" on ABC, the House speaker, [Nancy Pelosi](#), alluded to internal debate when she was asked whether nationalization, or partial nationalization, of the largest banks was a good idea.

"Well, whatever you want to call it," said Ms. Pelosi, Democrat of California. "If we are strengthening them, then the American people should get some of the upside of that strengthening. Some people call that nationalization.

"I'm not talking about total ownership," she quickly cautioned — stopping herself by posing a question: "Would we have ever thought we would see the day when we'd be using that terminology? 'Nationalization of the banks?'"

So far, [President Obama](#)'s top aides have steered clear of the word entirely, and they are still actively discussing other alternatives, including creating a "bad bank" that would nationalize the worst nonperforming loans by taking them off the hands of financial institutions without actually taking ownership of the banks. Others talk of de facto nationalization, in which the government owns a sizeable chunk of the banks but not a majority, with all that connotes.

That has already happened; taxpayers are now the biggest shareholders in Bank of America, with about 6 percent of the stock, and in Citigroup, with 7.8 percent. But the government's influence is far larger than those numbers suggest, because it has guaranteed to absorb the losses of some of the two banks' most toxic

assets, a figure that could run into the hundreds of billions of dollars.

Many believe this form of hybrid ownership — part government, part private, with the responsibilities of ownership unclear — will not prove workable.

“The case for full nationalization is far stronger now than it was a few months ago,” said Adam S. Posen, the deputy director of the Peterson Institute for International Economics. “If you don’t own the majority, you don’t get to fire the management, to wipe out the shareholders, to declare that you are just going to take the losses and start over. It’s the mistake the Japanese made in the ’90s.”

“I would guess that sometime in the next few weeks, President Obama and [Tim Geithner](#),” he said, referring to the nominee for Treasury secretary, “will have to come out and say, ‘It’s much worse than we thought,’ and just bite the bullet.”

So far the Obama administration has signaled that it is trying to avoid that day, and members of its economic team — among them Mr. Geithner and the president’s top economic adviser, [Lawrence H. Summers](#) — made the case during the Asian [financial crisis](#) in the 1990s that governments make lousy bank managers.

Indeed, the risks of nationalization they warned about then apply equally to the United States now. The first is that nationalization can prove contagious. If the Obama administration took over Bank of America and Citigroup, two of the largest banks in the United States, private investors could decide to flee from the likes of [JPMorgan Chase](#) and [Wells Fargo](#), or other major banks, fearing they could be next.

Moreover, Mr. Obama’s advisers say they are acutely aware that if the government is perceived as running the banks, the administration would come under enormous political pressure to halt foreclosures or lend money to ailing projects in cities or states with powerful constituencies, which could imperil the effort to steer the banks away from the cliff.

“The nightmare scenarios are endless,” one of the administration’s senior officials said.

The argument in favor of nationalization, even a brief nationalization of a few months or years, is straightforward: It might be the only way to pull America’s largest financial institutions out of the downward spiral that makes it enormously difficult to raise the capital they need to keep operating.

Right now, many banks are reluctant to write off their bad debts, and absorb huge losses, unless they can first raise enough capital to cushion the blow. But they cannot attract that capital without first purging their balance sheets of the toxic assets. Japan’s experience proved the dangers of that downward swirl; the economy stagnated, new lending ground to a halt and the country’s diplomatic clout shrank with its balance sheets.

Nationalization could pull the banks out of that dive, at least temporarily, as the government injected capital, hired new managers and ordered a restart to lending. But some Republicans who bit their tongues when President [George W. Bush](#) ordered huge interventions in the market would charge that Mr. Obama was steering America toward socialism.

Nationalization, said Charles Geisst, a financial historian at [Manhattan College](#) “is just not a term in the

American vocabulary.”

“We think of it,” he continued, “as something foreigners do to us, not something we do.”

It is also something foreigners do to themselves: the British have recently taken a majority stake in the Royal Bank of Scotland.

Some of Mr. Obama’s advisers have asked who the government would get to run the banks. Many of the most experienced executives are tainted by the decisions they made during the age of excess. And how would the government attract the best talent if it demanded that they take minimal pay — a political reality in the current environment?

Another option is for the government to buy the banks’ most toxic assets either through a giant fund, or, more likely, a federally supported bad bank designed to buy up troubled investments. But in that case, taxpayers might well be the losers: They would have all of the banks’ worst assets and none of their performing loans. And unless a deal is worked out to take a larger share of the banks whose bad loans are shuffled off to the government, the taxpayers would not have the chance to benefit by selling the shares back to private investors.

Moreover, cleaning up the banks’ bad assets, without extracting a heavy price for the bank managers, shareholders and their lenders, is exactly what Mr. Summers and Mr. Geithner warned against during the Asian financial crisis.

“We told the Asians that they had to be willing to let banks and companies fail,” said Jeffrey Garten, a professor at the Yale School of Management and a top official in the Clinton administration. “We warned that there was great moral hazard if governments just bailed them out.”

“And now,” he said, “we are doing the polar opposite of our advice.”

Eric Dash contributed reporting from New York.

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