



Nationalization, Will It Work?

The US economy has long been seen as the epitome of capitalism. It is a society which believes that market forces should lead to the efficient allocation of resources. It is these forces that would determine what goods are produced in society, how it is priced and how it would be distributed in society. In recent times, the unthinkable word of nationalization has been circulating around the US economy. As the recession deepens, US banks are requiring more and more federal funds to keep afloat. The question arises should the government pump more money into these institutions or should it 'take them over'.

Since TARP 1 in Oct. 2008, the US government has already invested about 200 billion in more than 400 banks. As part of the initial agreement, the government received preferred shares in these institutions which would pay an annual interest rate of five percent for five years. Recently the government made a change to their Financial Stability Plan. In exchange for funding, US banks would be given the option to convert the preferred shares now owned by the government to common stocks by the end of a specified period of time or else the shares will gradually convert to common stock over time. If the company does not want to convert to common stock, they must buy back the government's preferred stock before a certain period of time.

To determine which banks will receive additional funding from the government, Treasury Secretary, Tim Geithner announced through its FSP (Financial Stability Plan) that the government will stress test all banks, to examine their capital adequacy and determine which banks are worth saving. Should these financial institutions fall below the requirements, they would be forced to fund the inadequacy or accept funding based on the government's requirements.

What is Nationalisation?

A basic dictionary definition states that it is the act of transferring ownership from the private to the public sector.

What are the benefits of Nationalization?

1. Separate the bad bank from the good bank. Each economy needs a well functioning financial system. This ensures that credit worthy firms are given the opportunity to access much needed capital which would be used to generate loans that could prevent the economic recession from being prolonged. The good banks are allowed to function as normal while the bad banks are operations are taken over.
2. Furthermore this ensures that the toxic assets can be separated from the good assets. Previously, banks would use short term funds that they took in or borrowed against, to invest in illiquid assets such as loans and collateralized securities that had credit risks attached to it. Under normal circumstances, these would payoff. In bad times, these illiquid, defaultable assets tend to impair the liquidity and profitability of these financial institutions, which is currently

the case. Financial institutions would then be unwilling to sell these toxic assets because the price at which the market was offering would be too low and this would cause significant equity writedowns so much so that the banks could end up with negative equity on their books i.e. insolvency. Through nationalization the government would be able to take control of these toxic assets. They could transfer these assets to a separate institution (bad bank) to manage these assets so that when the price goes back up, it can be sold to realize to gain for taxpayers.

In the 1990s, Sweden had a similar situation. In the 1980s there was a real estate frenzy that drove prices up. Banks were lending and not worrying that the value of the collateral could evaporate in difficult times. By 1992-1993 the real estate bubble burst. After a series of bank failures and ad hoc measures of handing cash to banks in need, the government had to step in with more stringent measures as the recession deepened. What the Swedish government did was to:

- Scrutinize the books of each bank carefully to determine which one needed help. Banks had to write down their losses before coming to the state for assistance. This helped in determining not only what needed to be written down but also in determining the value of the assets.
- The toxic assets were separated from the non-toxic assets. Two agencies were formed. One was to supervise the institutions that needed recapitalization and the other was to sell off the assets that the banks held as collateral, mainly real estate (i.e. bad bank). The Swedish government had a policy which required banks to unload their collateral over three years rather than immediately. The aim of this was to reduce the pressure on short-term prices and to boost confidence that a recovery would take place. The bad banks, known as Asset Management Companies acted independently and were free from routing banking regulation and political interference.
- It issued blanket guarantees to creditors and funded the balance sheets with cash
- Top management in these institutions was replaced by executives more committed to risk management

In a short period of time, the government owned about 22 percent of all of the country's banking assets. By 1997, the Swedish economy picked up and the government was able to take some of these banks public, thus making a profit for taxpayers.

In contrast to the Swedish economy, Japan also faced a financial crisis in the 1990. This was also was caused by a burst of asset bubbles particularly in real estate and equities. Banks were left holding trillions of yens in loans that were practically worthless. The Japanese government injected about 1.8trillion yen in bailouts to Japanese banks. It tried everything that the US government is presently doing: low interest rates, and cash injections. They even tried to get private equity firms to purchase bad assets from the bank. In the end, the Japanese government had to nationalize banks, wipe out shareholder value and even allow some banks to fall under the burden of their debts. It was not until 2002, that the Japanese economy started to recover, which was six years after beginning of the crisis.

There is the criticism that the Swedish model won't work because Sweden is a small economy that does not have a complex financial system as the US. After all, 30-40% of Sweden's GDP is indirectly controlled by one family, the Wallenburgs, something that does not exist in the US.

In addition to this, it is argued that:

- Nationalized institutions will be seen as having an unfair competitive advantage. This is because investors would perceive that private institutions would have a higher risk as opposed to one that is owned by the government.
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- There is no specified exit strategy for the government. It may take a while before the government is fully able to return the banks to private sector.
- If you remove the senior management of these institutions, who will they place to replace them. These individuals already have the experience needed to manage institutions of this size and complexity.

Nationalization has its advantages as well as disadvantages. While nationalization may seem like taking a step backward, the US government needs to probably swallow its pride and consider it as an option for some banks such as Bank of America and Citibank. It should be noted that while it was successful for Sweden, a country which has about six major banks, it may not be entirely the remedy for the 7,500 banks in the US economy and more discrimination may have to be used in deciding who needs to be nationalized and who can fail. Nationalization should be used in conjunction with other measures which may cause banks to restructure in size and in the complexity of their operations so that the credit crunch may be prevented from worsening.

Current Happenings in Local and International Markets:

- IMF: Crisis starting to affect world's poorest countries
 - BNB of strategic value to Republic Bank
 - Government of Jamaica bonds downgraded by Moody's
 - Central Bank, private sector assure Guyana's financial system sound
 - Sagicor (Jamaica) records 33 per cent rise in net profits
 - Guardian Life Jamaica boasts 13% increase in new business
 - First Global gets US\$20 million from IFC to facilitate Jamaican businesses
 - Jobless rate jumps to 8.1 percent in February, highest since late 1983
 - Merrill Lynch Says It Discovered 'Irregularity' in Trading Unit
 - Wells Fargo slashes dividend 85 percent to 5 cents a share, expects \$5B annual savings
 - U.K. Profits Will Fall More Than in 1930s, Morgan Stanley Says
 - Australian Economy Shrinks for First Time in 8 Years
 - U.K. Consumer Confidence Stays Close to Four-Year Low
 - AIG Sued by Ex-CEO Maurice Greenberg Over 'Inflated' Shares
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Table 1: Regional Market Performance (as at 5 March 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	844.54	0.31	-0.37	0.19	-13.80
All Trinidad	1,150.50	-0.13	-0.07	-0.37	-3.88
JSE Index	82,427.30	-0.52	-3.87	2.84	-25.97
JSE Select	1,827.90	-1.17	-6.86	-7.90	-42.32
All Jamaica	66,892.05	-1.19	-8.41	-9.60	-42.10
BSE Composite	906.92	-0.46	-1.04	-1.41	-11.75

Table 2: International Market Performance (as at 5 March 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	682.55	-9.34	-19.31	-24.43	-48.82
Nasdaq Composite	1,299.59	-6.60	-15.95	-17.59	-42.82
Dow Jones Industrial	6,594.44	-8.18	-18.21	-24.86	-46.19
German Dax	3,695.49	-6.27	-18.07	-23.17	-44.71
FTSE 100	3,529.86	-9.85	-16.53	-20.39	-39.70
Nikkei 225	7,433.49	-0.33	-6.49	-15.02	-42.70
Hang Seng	12,211.24	-5.30	-7.34	-15.13	-47.17
DJ Eurostoxx	1,852.25	-8.36	-19.23	-24.44	-49.73

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