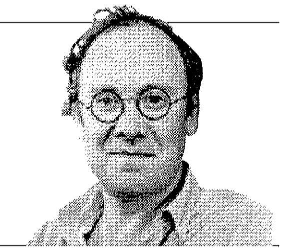
Opinion

An Englishman's allotment shed is his castle
Ben Macintyre, page 30



Obama, at last, has got it right. But will we?

The choice is simple: spend huge sums to save banks or face catastrophe by driving them to full-scale nationalisation

Anatole Kaletsky

President Obama has rediscovered his true voice and not a moment too soon. After spending the first month of his presidency telling the American people that their country was in a catastrophic and possibly irreversible economic crisis, Mr Obama suddenly reverted on Tuesday to the audacity of hope that got him into the White House.

Was this rhetorical U-turn a reaction to last week's very public advice from Bill Clinton not to over-egg the misery, or did it reflect a carefully considered political strategy of showing the American people that the President shared their pain before leading them out of the wilderness? These are questions that can be left to historians in the future. What is certain is that this rhetorical transformation has come just in the nick of time.

This week US consumer confidence fell to its lowest level on record, the US stock market plumbed depths not seen since 1997 and the US banking system seemed to be on the verge of another meltdown as the shares of the country's two biggest financial institutions, Citibank and Bank of America, plunged inexorably towards zero. This was a terrible start to the week in which the Administration had promised to announce details of the stress tests that were supposed to guarantee the stability of the US banking system. And, viewed from an international perspective, the evaporation of financial and consumer confidence in America created the worst possible background for the British Government's announcement this morning of measures to draw a final line under the losses at Royal Bank of Scotland and Lloyds.

Of course, the change in Mr Obama's tone is unlikely on its own to lift the mood of the American public, never mind the shell-shocked investors in bank shares, who have lost more than 90 per cent of their money in the past four months and seen the entire US banking system reduced to a lower value than the soft-drink sector.

Nevertheless, Mr Obama's words may prove to be crucial not only for America but also for Britain, for another reason connected with the public mood. Whether or not Mr Obama manages to revive consumer and investor confidence, his speech is likely to achieve another political objective. It is likely to change the terms of public debate about the role of government in this economic crisis and specifically about the need to channel public money, potentially without limit, into whatever measures may be required to support the banks.

To explain what I mean, I can do no better than quote some extracts from the most important passages in Mr Obama's speech. Their reception by the public will determine the outlook for the US and world economy for years ahead:

"If we do not restart lending in this country, our recovery will be choked off before it even begins. The flow of credit is the lifeblood of our economy. The ability to get a loan is how you finance the purchase of everything from a home to a car to a college education; how stores stock their shelves, farms buy equipment, and businesses make payroll.

"I know how unpopular it is to be seen as helping banks right now. But I also know that in a time of crisis, we cannot afford to govern out of anger, or yield to the politics of the moment. My job is to solve the problem. I will not spend a single penny for the purpose of rewarding a single Wall Street executive, but I will do whatever it takes to help the small business that can't pay its workers or the family that has saved and still can't get a mortgage. Because when credit is available again, that young family can finally buy a new home. And then some company will hire workers to build it... [Then] slowly, but surely, confidence will return, and our economy will recover."

If this message finally gets through and public opinion can be persuaded that supporting banks is about supporting bank depositors and business borrowers, not about subsidising greedy bankers, then there is a good chance that this week will mark a turning point. More precisely, this week will confirm the turning that actually occurred in many financial markets in November, around the time of Mr Obama's election.

If, on the other hand, public opinion rejects this message and forces American and British politicians to drive their banks into insolvency and full-scale nationalisation, then this week will mark the end of 200 years of market-based capitalism throughout the world.

The choice really is so simple and so stark. Suppose a leading bank were fully nationalised, wiping out by regulatory fiat the entire investment made by its shareholders, in the same way as the investors in Lehman Brothers and Fannie Mae were wiped out. It would then be a mathematical certainty that shareholders in all other banks would realise that they risked the same fate. One after the other, the share prices of all other big banks would fall to zero, requiring every leading bank, and ultimately also every leading insurance company in the world, to be nationalised. This was exactly the financial contagion that spread panic in September from Fannie and Lehman and then to every other bank in America, before leaping across the Atlantic Ocean to infect Halifax Bank of Scotland, Barclays, Lloyds and every leading European bank. I call this process Henry Paulson's Doomsday Machine, after the collapse of Fannie Mae and Lehman.

The President has made his case. Today's it's the Prime Minister's turn

Having seen the catastrophic results of Mr Paulson's decisions last autumn, it is hard to imagine that any responsible politicians would even consider reactivating his Doomsday Machine. Yet this is exactly what many economists, opposition politicians and financial commentators are demanding in Westminster and Washington. Worst of all, from both the standpoint of both the British and American governments, the demands for fiercer punitive action against the bankers evoke a powerful echo in media and public opinion.

Last autumn the Bush Administration decided to respond to this outcry by making a ritual sacrifice and chose Lehman as the scapegoat. The direct result was the greatest financial crisis of all time, in the carefully chosen words of the Deputy Governor of the Bank of England.

This week the British and American governments face the same temptation. After Mr Obama's speech it is fairly clear that the US Government will resist the easy populism and will instead spend whatever it takes to support America's banking system and to keep it in private hands. This morning, when the British Government reveals its support package for the Royal Bank of Scotland, we will know whether Gordon Brown has made the same choice.

Taxpayers in Britain should hope so. The more public money Mr Brown now commits to supporting the banks, the surer and faster will be the economic recovery and the smaller will be the ultimate loss of revenues to the Treasury, which stands to lose far more money from the recession than from the costs of any conceivable bank bailout.

As President Obama said: "While the cost of action will be great, I can assure you that the cost of inaction will be far greater." Were you listening, Mr Brown?