Sweden's response to bank crisis is instructive

by The San Diego Union-Tribune

Four months and $350 billion later, the federal government's initial response to the financial sector's meltdown doesn't seem to have worked. Tens of billions of dollars have been funneled to banks beset by "toxic assets" on the assumption that shoring them up would ensure their return to normal lending practices and thus end the credit crunch that is playing havoc with the economy. Instead, nearly all of these banks are as stingy with loans as ever.

It's time for the government to consider a more direct approach. In normal times, a huge government intrusion into the private sector would be indefensible. But these are not normal times. And the assumption that the government taking a larger role inevitably would go awry is belied by the success of the tactic used to end the savings and loan crisis in the late 1980s. After hundreds of lightly regulated savings and loans failed, a government entity was established to take them over and dispose of their assets. This was done with relatively little disruption to the economy.

With this crisis, the goal wouldn't be liquidating failed banks. Instead, it would be for the government to pay for majority equity stakes in troubled banks and then be given temporary operational control. Then these institutions' worst debts would be transferred to a government-established "bad bank," making their bottom lines functional and allowing them to return to normal operations. When the economy stabilized, the government would sell off its stakes and get out of the banking business. Just such a policy worked wonders with Sweden in 1992 when its housing bubble burst and its largest banks were on the verge of collapse.

This is not, repeat, not the same thing as nationalization. That is "the wrong word because it suggests the wrong endgame," wrote conservative Harvard economist Greg Mankiw, the former chairman of the White House Council of Economic Advisers. "If banks are as insolvent as some analysts claim, then the goal should be a massive reorganization of these financial institutions. Some might call it nationalization, but more accurately it would be a type of bankruptcy procedure."

Mankiw isn't sure this is the best option â€” yet. Nor are we. Still, the number of economists from across the ideological spectrum who are coming around to this approach is striking. New York University's Nouriel Roubini, a free-market economist who was one of the few to predict the severity of our current downturn, is only the latest.

We hope President Barack Obama and Treasury Secretary Timothy Geithner are willing to listen to Roubini, Mankiw and others. The economy will never rebound until the banking crisis ends â€” and so far, there's no evidence our current banking fix is working. Reprinted From The San Diego Union-Tribune. Distributed By Creators Syndicate Inc.

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