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Don't sell taxpayers short

By holding on to its share in the banks, the government could help ensure this crisis doesn't recur



Henning Meyer

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Gordon Brown took a global lead with his comprehensive bail-out package for British banks. The PM's rescue plan, which was emulated in the US and across Europe, is a bold set of measures that marks a departure from the economic orthodoxy of recent decades.

But not everybody is applauding the shift. US treasury secretary Hank Paulson in particular showed his distaste for part-nationalising the US banking sector. The former CEO of Goldman Sachs accepted state involvement in the banking industry only as the least worst option in the short term. But what's wrong with state involvement in the financial sector – even in the long term?

Most commentators agree that a tighter regulatory framework must be at the heart of remodelled financial markets. But this tighter framework has to be enforced. This requires supervisory capabilities on all levels. Whether there will be some sort of international financial services authority – which is preferable – or just better cooperation between existing national regulators, the early warning system must be significantly improved. Individual banks could carry out extra supervision, especially if the government is a shareholder.

I previously wrote that the government's role as insurer of last resort for financial institutions has changed the relationship between civil society – represented by government – and the financial industry. And given the amount of taxpayers' money the state has pumped into the financial system, citizens can expect that their government keeps a close eye on banks. A "no questions asked" blank cheque for banks would contradict all principles of prudent governance. So the government has two reasons to monitor banks' activity: to make sure that taxpayers' money is used efficiently, and to help prevent future crises. These conditions must be attached to the bail-out.

But if the chief short-term reason for government involvement in financial institutions is to create trust, I can't see why reasonable state involvement in banks could not stabilise the volatile financial sector for the foreseeable future. I am not proposing the long-term nationalisation of the banking sector, or that the government should try to run or micro-manage individual banks. But why can't it remain a minority shareholder in those banks deemed essential for the stability of the financial system? Of course, such a minority share shouldn't destroy the profitability of banks, but it could ensure that stability is maintained and that citizens too benefit once the current turmoil is over.

A government presence on a bank's supervisory board would give other shareholders a better chance of keeping track of how their investments are being managed. In the UK, these supervisory boards are unusual and introducing them would require corporate governance reform. But that would not be difficult.

The European Company Statute, adopted in 2001, allows for the setting up of European Public Companies (SEs) in all EU member states. An SE can be created by simply converting an existing company, and can operate under a two-tier system which includes a supervisory board that controls the management board. Applying this corporate structure to financial institutions is not a problem, as the example of Allianz shows. The biggest German financial services company became an SE in 2006. An additional benefit would be that SEs make pan-European activities and mergers easier, which was the initial reason for introducing a European Company Statute.

So, in order to monitor companies and markets better and stabilise the financial system in the long term, why do governments not maintain a minority share in important financial institutions and exercise the supervision rights that can come with it? This model is not a socialist nationalisation of the banking sector, which would indeed be very unhelpful. But it is not a return to the now failed system either. It would reflect the new relationship between governments and the financial sector – with which neither has yet come to terms – and make sure that taxpayers can benefit financially from the unprecedented guarantees they are currently forced to give.

A system like this would not prevent future crises, but it would make it easier to identify problems before they grew into full-blown catastrophes. Isn't that what is needed above all?

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