[Ten years on from Lehman – there was an alternative to buying shares in the banks]

I reproduce today a post I wrote almost ten years ago, as one who saw the banking crash coming. I urged lower interest rates on March 10 2008, March 28 2008 and finally proposed halving rates on July 18 2008 to relieve the fierce squeeze and the difficulties rates were imposing on borrowers. I argued against the severity of the money squeeze administered in 2008, and argued that shareholders and bondholders should take the hit of the losses incurred, with private sector refinancing of the strengthened banks. RBS, for example, had plenty of assets and trading businesses to sell to generate cash and slim its bloated balance sheet. This approach was finally adopted for future crises, with the living wills idea for banks, but was not adopted for the crisis we were living through. As a result it took longer to sort out the banks and additional resentment grew against them given their easy access to taxpayer investment in shares.

We need a better recovery plan

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It is usually dangerous when the Establishment unites behind a single policy and says there is no alternative. The last time that happened in the UK we were lumbered with the Exchange Rate Mechanism which gave us a rapid inflation followed by a recession.

Recently in the USA the Republican and Democrat leadership united with both Presidential candidiates behind the Paulson plan. That plan turned out to be bad politics, failing its first vote in Congress, and bad economics, leading to subsequent modification by its own author.

Today I suggest a threefold aproach to the crisis.
The first is to amend the government's way of handling its approach to the banking crisis.
I fully support the provison of liquidity and longer term loans to the banks. They must take full security for these advances to protect the taxpayer. The withdrawal of too much liquidity at times over the last fifteen months has intensified the crisis.
The government should not spend £37 billion it cannot afford on buying bank shares. It should refuse to finance the HBOS/LLoyds merger, leading to LLoyds going it alone in the private market for its capital needs. The Regulators should give HBOS and RBS time to increase their capital ratios, whilst the government makes it clear it stands behind both banks with loans and cash if needed. They could both improve their capital ratios by stopping dvidend payments, cutting very high pay and bonuses, reducing staff through natural wastage and other cost reducing measures, and reducing their loan books. It should be their choice which combination of these measures they adopt.

The government and Bank are right to experiment with other ways of lending and using guarantees to get the banking markets moving again.

The second is to get control of the public finances. Cancelling the £37 bllion will help. There are many other ways of starting to control pubic spending, whilst keeping every nurse, teacher, doctor and teacher and other important public service workers.

The third is to take action to stimulate the private sector, which is crashing downwards rapidly. That means cutting interest rates by 200 basis points or 2% immediatey, with the prospect of more to come if needed. It means working with the energy, water and transport industries to see which larger investment projects can be brought forward to provide some work for the construction industry. It means redoubling efforts to help people back into work who lose their jobs as the redundancies build up this winter.