

EXPROPRIATION OF THE BRITISH BANKING SECTOR

Tim Congdon

Early 2009 has seen intense concern in the media about British banks. Are they bust? And should the government nationalise them?

Many thousands of internal auditors are constantly at work collecting data on banks' operations, and translating the information into profit and loss numbers, balance sheets, cash flow statements and so on. Every six months a few thousand external auditors check the results, which are published for the benefit of shareholders and others. Hundreds of regulators are kept informed virtually all the time about how the figures are evolving.

One product of this immense labour is banks' published balance sheet information, for which the last available date is 31 December 2008. At that time HSBC had shareholders' capital of \$100 billion (call it £70 billion), Royal Bank of Scotland of £80 billion, Barclays £37 billion, HBOS over £12 billion and Lloyds TSB £10 billion.

If these organisations are taken to define 'the British banking system', its capital at end-2008 was over £220 billion. HSBC might be excluded on the grounds that it is really a Hong Kong Chinese bank, which was persuaded in the mid-1990s to move its headquarters to London on political grounds. If so, British banks' capital less than six months ago was over £139 billion.

A sum of £139 billion is a large amount of money. Either it exists or it doesn't. The armies of bank executives, accountants and regulators who agree – more or less – on this number can appeal to audit rules and principles built up over many decades to justify their verdict. Can all these people be wrong? And – if they are wrong now – why were much the same people not also wrong at end-1995 or mid-2005 or end-2006, when their deliberations were less newsworthy than they are today?

Nevertheless, many politicians and commentators have claimed that 'Britain's banks are bust' and that, because they are bust, they 'must be nationalised'. These politicians include such prominent figures as Vincent Cable, Deputy Leader of the Liberal Democrats, and John McFall, Chairman of the Treasury Select Committee. They have asserted, in effect, that over £100 billion has somehow vanished into a financial black hole. Cable and McFall seem to be saying that the professional staff responsible for estimating

banks' profits and capital don't know what they are doing.

The size of banks' capital is fundamental if nationalisation does become a genuine possibility. We live in civilised societies under the rule of law that defend property rights, don't we? If a government nationalises a company, it must compensate shareholders. According to most legal precedents in the European Union, 'book value' is the right basis for such compensation. The precise meanings of 'book value' and 'capital' are for debate, but a fair summary is that – if it wanted both to nationalise the UK banking system and to respect property rights – the government would have to pay about £139 billion. But, if 'the banks are bust' brigade had their way, the figure would be zero.

In 2008 the government nationalised two banks (Northern Rock and Bradford & Bingley) and passed legislation designed to ensure that shareholders received next to nothing in compensation. The justification for the government's action was that the two banks had difficulty financing their assets because of the breakdown of the international wholesale funding market and so were dependent on loans from the state to continue in business. Given this dependency, why was the state not entitled to strip the shareholders of everything?

In recent months the same argument has been heard about RBS, Barclays and Lloyds. Like Northern Rock and Bradford & Bingley, these organisations would not today be able to fund their assets unless the state helped them. Despite their scale and prestige, despite their distinguished past and their technical expertise, and indeed despite their £139 billion of capital, the three leading British banks would have trouble financing their operations unless the Treasury and the Bank of England gave them explicit and implicit guarantees.

The dissolution of Britain's banking industry under the Gordon Brown premiership bears comparison with the dissolution of the monasteries under Henry VIII. Arguably, the British state threatens to expropriate assets rather than nationalising them.

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