US Treasury Secretary Henry Paulson announces the Treasury Department's plan to take equity stakes in potentially thousands of banks totaling about $250 billion as Federal Reserve Chairman Ben Bernanke looks on.
Photo: *Reuters*

US bites bullet and invests in banks

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NEW YORK - The Bush administration has resigned itself to investing directly in its banks - for more than a century the emblems of free-market capitalism - in a move opposed to its guiding principles and past policy, analysts said.

"We regret having to take these actions. Today's actions are not what we ever wanted to do - but today's actions are what we must do to restore confidence to our financial system," said Treasury Secretary Henry Paulson.

This time with $US250 billion ($A360 billion) being pumped into the system to buy up stakes in banks, there have been no accusations of "socialism" in contrast to when insurance giant AIG was nationalised in September.

This reflects a change in attitude among legislators who now realise the gravity of the situation.

"Today's actions are not what we ever wanted to do - but today's actions are what we must do to restore confidence to our financial system," said Paulson, a former head of Wall Street investment house Goldman Sachs.

Republican Congressman Spencer Bachus, number two in the House of Representatives financial services committee, saluted the government initiative.

"A direct capital injection is the quickest, most direct and safest use of the taxpayers' money to reduce the market turmoil threatening our economy and restore confidence in our markets," he said in a statement.

Paul Krugman, newly crowned this week with the Nobel prize for economics, welcomed an approach he likened to the policies of Democratic president Franklin D Roosevelt, who shepherded the country out of the Great Depression of the 1930s.

"We're not going to go back to Karl Marx," Krugman told the CNBC network, referring to the 19th century philosopher and author of the "Communist Manifesto."

"But we are going to re-discover some of the things that Franklin Roosevelt learned 75 years ago," he said.

"It does turn out that a certain amount of public intervention, oversight, and, in crisis, partial takeover of the financial system is something you have to do," he added.

"Leaving the financial system to work things out on its own was disastrous in the 1930s and brought us to the brink of disaster again now."

Several financial analysts and university professors had advocated similar solutions, and today's announcement was largely positively received.

"It took a while, but US policymakers have finally deployed measures aimed directly at the heart of the problem," said economist Aneta Markowska of Societe Generale.

"Both the Treasury secretary and the chairman of the Federal Reserve (Ben Bernanke) have finally declared war on the financial crisis, and this may well represent a critical turning point," said Brian Bethune of Global Insight.

Duke University academic Campbell Harvey, who too had pleaded for a similar solution, was pleased by the government's initiative.

But he was disturbed by the "reactive" measures taken in September, when the administration was "putting out one fire after the other" but left Street giant Lehman Brothers to crumble.

"It's an investment that has multiple strings attached to it," Harvey told AFP.

"There are reasons (for some banks) not to do it -- this is not without cost," he said, adding the government secured returns of key dividends of five per cent per year for the first five years and nine per cent annually thereafter.

Harvey expressed worry over the plan's "voluntary" nature. "Some healthy institutions are not going to take the capital," he said. "It's like a stigma issue ... It might signal that they're not as healthy as people thought."

That might mean that some smaller banks may pass up the opportunity which could have a fallout for some small and medium-sized businesses.

Influential Democratic Senator Charles Schumer gave the plan good marks but rued that it failed to ban certain "exotic financial instruments."

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