The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

How Much Nationalization Is Appropriate?

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We in the United States live in a country with a strong tradition of private ownership of companies. In recent days, we have seen changes that border on nationalization:

• The support given to JP Morgan Chase in its purchase of Bear Stearns

• The bailout of Fannie Mae and Freddie Mac

• The take-over of AIG, providing a $85 billion loan in exchange for 80% of the company

• Extension of FDIC guarantees to money market accounts

• The Fed's purchase of commercial paper, to support that market

• Most recently--the Fed's decision to start lending directly to corporations

How much more of this can we expect to see in the days ahead? What indirect impacts will this have on American businesses? Where does all of this end?

The purpose of this post is to offer readers a chance to talk about where they see this issue going. Below the fold, I offer a few thoughts on what areas arguably need federal support, and a few implications if the country moves toward more nationalization of companies.

Organizations possibly needing more federal support

Bankrupt large banks (or even small banks)

FDIC insurance is only $250,000 per account, dropping to $100,000 an account January 1, 2010. This limit is fine for personal accounts, but it is not nearly enough for companies (or governmental organizations) with thousands of employees. These companies spend more than $250,000 for payroll each pay period. They are also likely to need accounts with very large balances in order to issue checks to vendors. If the banks that handle these accounts are allowed to go bankrupt, the corporations with these accounts might lose a large amount of money, and would have difficulty with future payroll checks and checks to vendors. While some businesses could split their accounts among banks, this becomes difficult if dozens of banks are needed for ordinary transactions.

Federal Deposit Insurance Corporation (FDIC)

The FDIC guarantees bank deposits, now up to $250,000 per account, but does not have much to in actual funds to back up this guarantee (something like $45 billion). The usual method of obtaining additional funding is by charging higher insurance premiums to banks for the coverage. In the recent past, these fees have only amounted, in total, to a few billion dollars per year. It is doubtful that the fees can be raised to a high enough level that they will pay all of the losses occurring--without bankrupting additional banks.

Pension Benefit Guarantee Corporation (PBGC)

The PBGC is similar to the FDIC, except that it guarantees the payment of pension plans. It has exactly the same problem in terms of funding that FDIC has--the methodology works fine for an occasional bankruptcy, but not if there are multiple pension plans failing at the same time, because they hold securities that no longer have value, or because they are invested in the stock market, and the stock market has not increased as much as planned.

Insurance Companies

Insurance companies are not the first to be affected by problems with investments, but as more companies and governments default on their bonds, they are likely to be affected as well. Insurance companies are covered by state guarantee funds in the case of insolvency, but the coverage offered by the funds has many exclusions and low limits. These funds are assessment plans that collect funds from solvent insurers to pay for those that are insolvent. This approach works well for an occasional bankruptcy, but not if there are multiple large insurance company failures.

Oil and Gas Companies

Oil and gas companies are frequent targets for government takeovers for a number of reasons. For one thing, governments see them as a possible source of extra revenue. Also, if rationing is necessary, it may be easier for rationing to be carried out according to governmental plans, if a company is under government supervision. Another issue is price subsidies; the prices charged by oil companies may be perceived to be too high for consumers. Another consideration may be declining production. If the government is in charge, there can be no question whether the amount of exploration and drilling is adequate.

Parts of the Electric Utility Industry

We know that the grid has been neglected for years. No one has clear responsibility for maintaining and upgrading it, so this is a logical area for governmental support. Also, if there are bankruptcies of companies necessary to electricity transmission over the grid, the federal government may want to intervene to prevent service interruptions. Another area where government support may be needed is in the funding of new nuclear plants, if these are added.

Railroad Tracks

If we want to upgrade our railroad system, some might argue that the best way would be to have the federal government take responsibility for maintaining and upgrading the railroad tracks, similar to the way it maintains the interstate road system.

Airline Industry

If airline service to smaller cities disappears, so will the prospects for new industries for these cities. Some are likely to argue that the airlines need support to maintain service to smaller airports (or to stay in business at all).

Auto Manufacturers

If General Motors and Ford go bankrupt, should the government just stand by?

Housing Problems

A federal program to assist in homeownership, and help stop falling prices, has been proposed.

New manufacturing

We have off-shored a huge amount of manufacturing. If we want to bring some of this manufacturing back on-shore and financing is still very tight, it may be necessary for the federal government to provide support to the new manufacturers.

State and local governments

I understand that California is now looking for loans. In the months ahead, there will no doubt be many others. I don't think state and local governments can be nationalized, but they can come to depend on assistance from the federal government.

Risks

Need for ongoing infusion of funds The reason all of these organizations (except the oil and gas companies) need help is because they are short of funds. If they were short of funds before the first infusion of funds, they are likely to still be short of funds later, especially if the current financial problems are not just the result of a cyclic downturn. It seems likely the downturn will last, because the total amount of debt outstanding is unreasonable relative to the amount of underlying resource. In addition, oil and other energy prices are now higher, because of oil shortages. The higher energy prices make debt more difficult to pay back, and are likely to limit future growth.

Government as poor business manager Governments have a reputation for hiring people who are not necessarily competent, and keeping more people on the staff than necessary. Some have suggested that with the government involved and shortages of some goods, bribery may be more of an issue.

Sudden devaluation of the dollar With the government trying to take on all kinds of additional responsibilities, it is not clear where all of the additional funding will come from. At some point, faith in the dollar is likely to evaporate.