Nouriel Roubini: 'Nationalize' the Banks

Dr. Doom says a takeover and resale is the market-friendly solution.

By TUNKU VARADARAJAN

New York

Nouriel Roubini is always dressed in black-and-white.

I have known him for nearly two years, and have seen him in a variety of situations -- en route to class at New York University's Stern Business School, where he's a professor; over a glass of wine in his boyish loft in Manhattan's Tribeca; at an academic conference, seated sagely on the dais; at a bohemian party in Greenwich Village, at . . . oh . . . 3 a.m. -- and he always, always wears a black suit with a white linen shirt.

And so, in black-and-white he was, earlier this week, when he rushed into the office of Roubini Global Economics, his consulting firm in downtown Manhattan, and offered a breathless apology to this correspondent, who'd been waiting for half an hour. "Really sorry I'm late! Charlie Rose taped for way longer than he said he would."

Mr. Roubini -- a month short of 50 -- is in huge media demand, the nearest thing to a rock-star among the economists who hold our fate in their hands these days. The peculiar thing, of course, is that he's in demand because he specializes in predictions of gloom. (He has earned himself the sobriquet of "Doctor Doom"). In person, though, he's anything but a downer.

The man has instant impact on public debate.

An idea he floated only last week -- that our "zombie banks" be temporarily nationalized -- aired first on Forbes.com, where he writes a weekly column. It has evolved, in the space of just a few days, from radical solution to almost received wisdom.

Last Sunday on ABC, George Stephanopoulos asked Lindsey Graham, the conservative Republican senator, what he thought about all this talk of bank nationalization. Mr. Graham said that he wouldn't take the idea off the table. And on Wednesday, Alan Greenspan told the Financial Times that "it may be necessary to temporarily nationalize some banks in order to facilitate a swift and orderly restructuring."

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Mr. Roubini tells me that bank nationalization "is something the partisans would have regarded as anathema a few weeks ago. But when I and others put it in the context of the Swedish approach [of the 1990s] -- i.e. you take banks over, you clean them up, and you sell them in rapid order to the private sector -- it's clear that it's temporary. No one's in favor of a permanent government takeover of the financial system.*

There's another reason why the concept should appeal to (fiscal) conservatives, he explains. "The idea that government will fork out trillions of dollars to try to rescue financial institutions, and throw more money after bad dollars, is not appealing because then the fiscal cost is much larger. So rather than being seen as something Bolshevik, nationalization is seen as pragmatic. Paradoxically, the proposal is more market-friendly than the alternative of zombie banks."

In any case, Republicans must now temper their reactions, he says. "The kind of government interference in the economy that we saw in the last year of Bush was unprecedented. The central bank -- supposed to be the lender of the last resort -- became the lender of first and only resort! With our recapitalizing of financial institutions, and massive government intervention in the markets, we've already crossed a significant bridge."

So, will the highest level of government be receptive to the bank-nationalization idea? "I think it will," Mr. Roubini says, unhesitatingly. "People like Graham and Greenspan have already given their explicit blessing. This gives Obama cover. And how long will it be before the administration goes in formally for nationalization? I think that we're going to see the policy adopted in the next few months . . . in six months or so."

That long? I ask. "Six months from now," he replies, "even firms that today look solvent are going to look insolvent. Most of the major banks -- almost all of them -- are going to look insolvent. In which case, if you take them all over at once, you cause less damage than if you would if you look over a couple now, and created so much confusion and panic and nervousness."

"Between guarantees, liquidity support, and capitalization, the government has provided between $7 trillion to $9 trillion of help to the financial system. De facto, the government is already controlling a good chunk of the banking system. The question is: Do you want to move to the de jure step."

Yet another reason why bank nationalization is a good idea, Mr. Roubini continues, is that "we started with banks that were too big to fail, but what has happened, in the process, is that these banks have become even-bigger-to-fail. J.P. Morgan took over Bear Stearns and WaMu. BofA took over Countrywide and then Merrill. Wells Fargo took over Wachovia. It doesn't work! You can't take two zombie banks, put them together, and make a strong bank. It's like having two drunks trying to keep each other standing."

"So if you took over a big bank, and you split the assets in three or four pieces, maybe you create three or four regional or national banks, and they're stronger! Nationalization -- or 'temporary receivership,' if you like, if the N-word is a political liability -- is an occasion to undo the sort of consolidation that has created an even bigger systemic problem. And the only way to do it is by essentially taking them over and breaking them up."

Here, I ask Mr. Roubini whether he has been more right -- more prescient -- in his reading of the economic downturn than all the other famous bears in America. After all, judging by the attention paid to him in the press, it is hard not to conclude that he is the leading guru of the current recession, or "near-depression," as he often calls it. My question, remarkably, induces in him some diffidence. "I don't want to personalize the analysis, you know . . . because, first of all, there were many people who got many of the elements right."

"People like [Robert] Shiller were very worried about the housing bubble. People like Steve Roach were worried about an economy based on asset bubbles leading to consumption bubbles that were unsustainable. People like Ken Rogoff talked about global imbalances in the current account deficit not being sustainable. Nassim Taleb has been worrying for a while about 'fat tail' events . . . . So lots of people signaled concern about things. I was one of those who put the dots together and thus gave a more fleshead-out picture."

To Mr. Roubini, the most interesting question isn't the one of who got it right. Instead, he asks why we keep over and over again, get into these periods of irrational exuberance, when not only is there an asset bubble and a credit bubble, but people believe these are sustainable over a long time -- Wall Street, policy makers, rating agencies, academics, journalists . . . ."
What exactly is Nouriel Roubini's economic philosophy? "I believe in market economics," he says, with some emphasis. "But to paraphrase Churchill -- who said this about democracy and political regimes -- a market economy might be the worst economic regime available, apart from the alternatives.

"I believe that people react to incentives, that incentives matter, and that prices reflect the way things should be allocated. But I also believe that market economies sometimes have market failures, and when these occur, there's a role for prudential -- not excessive -- regulation of the financial system. The two things that Greenspan got totally wrong were his beliefs that, one, markets self-regulate, and two, that there's no market failure."

How could Mr. Greenspan have been so naïve, I ask, hoping to get a rise. "Well," says Mr. Roubini, "at some level it's good to have a framework to think about the world, in which you emphasize the role of incentives and market economics . . . fair enough! But I think it led to an excessive ideological belief that there are no market failures, and no issues of distortions on incentives. Also, central banks were created to provide financial stability. Greenspan forgot this, and that was a mistake. I think there were ideological blinders, taking Ayn Rand's view of the world to an extreme.

"Again, I don't want to personalize things, but the last decade was one of self-regulation. But in the financial markets, without proper institutional rules, there's the law of the jungle -- because there's greed! There's nothing wrong with greed, per se. It's not that people are more greedy now than they were 20 years ago. But greed has to be tempered, first, by fear of losses. So if you bail people out, there's less fear. And second, by prudential regulation and supervision to avoid certain excesses."

How does Mr. Roubini think the media has covered the financial crisis? "The problem," he says -- after first stating to me that he intends "no offense!" -- "is that in the bubble years, everyone becomes a cheerleader, including the media. This is the time when journalists should be asking tough questions, and I think there was a failure there. The Masters of the Universe were always on the cover, or the front page -- the hedge-fund guys, the imperial CEO, private equity. I wish there had been more financial and business journalists, in the good years, who'd said, 'Wait a moment, if this man, or this firm, is making a 100% return a year, how do they do it? Is it because they're smarter than everybody else . . . or because they're taking so much risk they'll be bankrupt two years down the line?'

"And I think, in the bubble years, no one asked the hard questions. A good journalist has to be one who, in good times, challenges the conventional wisdom. If you don't do that, you fail in one of your duties."

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