deal with the problem of inadequate financial capital by having governments provide financial institutions with more capital in return for a share of ownership.

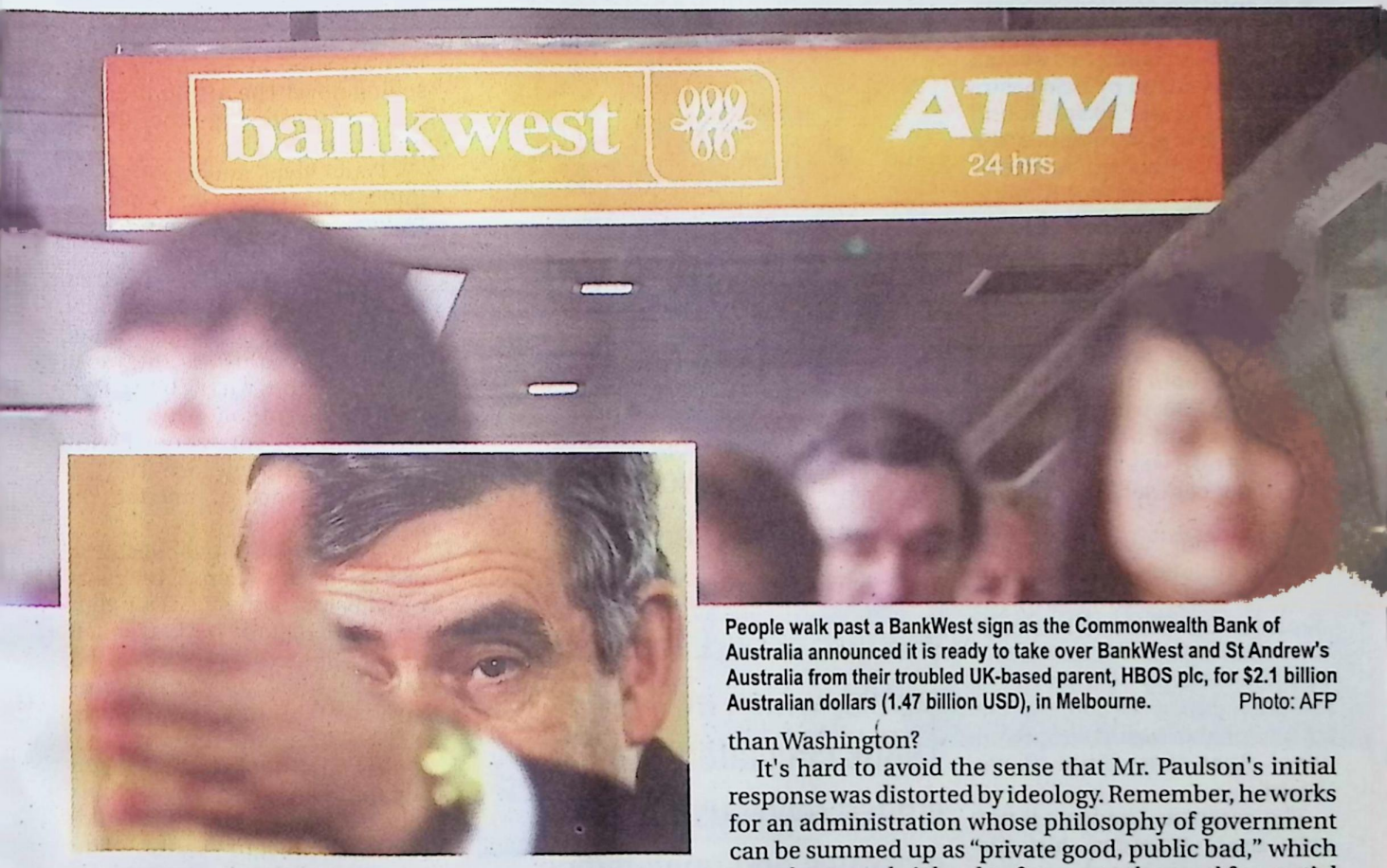
This sort of temporary part-nationalization, which is often referred to as an "equity injection," is the crisis solution advocated by many economists -- and sources told The Times that it was also the solution privately favoured by Ben Bernanke, the Federal Reserve chairman.

But when Henry Paulson, the U.S. Treasury secretary, announced his plan for a $700 billion financial bailout, he rejected this obvious path, saying, "That's what you do when you have failure." Instead, he called for government purchases of toxic mortgage-backed securities, based on the theory that ... actually, it never was clear what his theory was.

Meanwhile, the British government went straight to the heart of the problem and moved to address it with stunning speed. On Wednesday, Mr. Brown's officials announced a plan for major equity injections into British banks, backed up by guarantees on bank debt that should get lending among banks, a crucial part of the financial mechanism, running again. And the first major commitment of funds will come on Monday five days after the plan's announcement.

At a special European summit meeting on Sunday, the major economies of continental Europe in effect declared themselves ready to follow Britain's lead, injecting hundreds of billions of dollars into banks while guaranteeing their debts. And whaddya know, Mr. Paulson -- after arguably wasting several precious weeks has also reversed course, and now plans to buy equity stakes rather than bad mortgage securities (although he still seems to be moving with painful slowness).

As I said, we still don't know whether these moves will work. But policy is, finally, being driven by a clear view of what needs to be done. Which raises the question, why did that clear view have to come from London rather than Washington?



People walk past a BankWest sign as the Commonwealth Bank of Australia announced it is ready to take over BankWest and St Andrew's Australia from their troubled UK-based parent, HBOS plc, for $2.1 billion Australian dollars (1.47 billion USD), in Melbourne. Photo: AFP

It's hard to avoid the sense that Mr. Paulson's initial response was distorted by ideology. Remember, he works for an administration whose philosophy of government can be summed up as "private good, public bad," which must have made it hard to face up to the need for partial government ownership of the financial sector.

I also wonder how much the Femafication of government under President Bush contributed to Mr. Paulson's fumble. All across the executive branch, knowledgeable professionals have been driven out; there may not have been anyone left at Treasury with the stature and background to tell Mr. Paulson that he wasn't making sense.

Luckily for the world economy, however, Gordon Brown and his officials are making sense. And they may have shown us the way through this crisis.

Paul Krugman has won this year's Nobel prize for economics.
Source: New York Times