British government mounts new bank bailout amid warnings of economic collapse

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Britain's Labour government announced another massive bank bailout on Monday. It comes just months after the same banks received a £500 billion "aid" package from the government that included buying up shares in Britain's leading high street banks and providing loan guarantees and credit facilities.

Prime Minister Gordon Brown had claimed of his October bailout that it had "saved the banks". In reality, the global economic crisis has intensified, plunging the UK into the worst recession since World War II.

The latest measures came as the Royal Bank of Scotland (RBS), one of Britain's largest banks, posted a loss of £28 billion for 2008—the largest corporate loss in UK history. This includes a £20 billion write-down of its purchase of Dutch bank ABN Amro and US bank Capital One.

Banking shares collapsed due to fears about further losses and the expiry of the short-selling ban at the weekend, threatening to pull down the entire banking sector, Britain's largest and most important industry.

RBS' shares are worth just 10 percent of their value two years ago. On Friday, Barclays Bank, which has so far avoided part-nationalisation by the government by seeking funds from Middle East investors, saw its share price collapse by 25 percent.

Overall, British banks are set to lose £85 billion over the next three years, far in excess of the £50 billion of fresh capital under the October bailout.

According to the *Financial Times*, the Chancellor of the Exchequer Alistair Darling admitted that he had not known about the banks' huge losses when he authorised the purchase of bank shares at prices above the market price.

Despite handing over hundreds of billions of taxpayers' money, Darling claimed that there had been no time in October to fully scrutinise RBS' books, as the government's priority had been to prevent the collapse of the banking system.

Such was the government's anxiety to announce its latest rescue plan that it has yet to be finalised.

Darling claimed the new package was needed because a collapse of the banking system would bring the entire economy "down with it". The chancellor and the prime minister have refused to specify how much the measures will cost or where the money will come from. Financial commentators believe it could be more than £350 billion.

Everything points to another series of hasty improvisations whose bottom line is to provide the means for the financial elite to continue "business as usual" at the expense of millions of working people.

The first measure, aimed at ring-fencing the banks' toxic assets, will provide insurance for the banks against borrowers defaulting on their existing loans. Under this Asset Protection Scheme, the banks will pay the government a flat fee, and then the state will cover approximately 90 percent of the losses should the borrower default. In return, the banks will have to commit to lending more.

The details of the scheme are subject to negotiations that will not be completed until the end of February.

The government has said that it will send in accountants, lawyers, bankers and financial consultants to establish the value of the assets and level of insurance required. The *Financial Times* cited an unnamed government official as describing it as "a job-creation exercise for the City". While the remark may have been intended as a joke, it is in essence the content of the entire rescue package.

While the government claims that it will not have to negotiate with the banks over the value of the loans, as it would if it were setting up a stand-alone "bad bank", a solution that had been touted by some, that is exactly what it will be doing, with even less transparency.

Those banks that have not yet written down their bad debts will be required to do so or absorb greater losses than those that have. But since there is no market for such loans, it is unclear what their value is or whether they have any value at all. The Asset Protection Scheme paves the way for the taxpayers to assume the burden of all the banks' toxic assets.

Under the second measure, the government will extend its £250 billion Credit Guarantee Scheme, which enables banks to raise funds by issuing new wholesale debt with a five-year maturity date until the end of the year.

Third, the state will guarantee £100 billion of asset-backed securities such as mortgages, corporate and consumer debt in an attempt to boost the wholesale markets.

Fourth, while the government's £200 billion Special Liquidity Scheme will close at the end of this month, it has put in place other mechanisms to achieve the same effect. The Discount Window allows banks to swap "assets" such as sub-prime mortgages for more liquid assets such as government bonds. For an extra fee, they can be swapped for one year instead of one month.

The government will also ease the terms of the October bailout by offering to convert its preference shares in RBS, Lloyds TSB and HBOS into ordinary shares. In the case of RBS, this increases the government's stake from 58 percent to nearly 70 percent and saves RBS £1 billion a year by not having to pay a 12 percent interest charge on the shares to the government. In return RBS will be required to increase its lending to £6 billion next year.

Northern Rock, which was nationalised last February to stave off bankruptcy, will be allowed to hold onto its mortgage loans rather than selling them off. This will mean repaying its debt to the government more slowly.

In another policy reversal, the Financial Services Authority (FSA) has reduced its requirement for banks' first tier capital from 8 percent to 4 percent for those banks that took part in the first bailout in an effort to get them to restart lending.

Last and by no means least, the Treasury has followed the US Federal Reserve and put in place the mechanisms, euphemistically called "quantitative easing", that will allow the Bank of England to inject money into the financial system. This will enable the Bank to lend to the non-financial sector by buying up assets such as corporate bonds, commercial paper and syndicated loans under the Asset Purchase Facility, up to £50 billion in the first instance.

The claim is that this will ensure funds are available to corporations requiring credit where they are unable to raise loans from the banks. According to the *Financial Times*, the top 350 listed companies are due to refinance £210 billion of loans over the next five years. Without such a mechanism in place, auditors may refuse to sign off annual accounts as going concerns, effectively bankrupting numerous corporations.

The Asset Purchase Facility also means that the Bank will take on the risk of corporate default on the loans. But since the Bank does not have the funds, the Treasury will provide the Bank of England with the necessary cash by issuing government debt and indemnify the Bank against default risk. Thus while the Bank is the conduit for lending to the corporate sector, it is the taxpayers who are, in reality, the bankers.

The big four high street banks have a combined loan book of more than £6 trillion, more than four times Britain's annual GDP of £1.3 trillion or 15 times the government's officially recognised debt.

To put this in some kind of perspective, even a 10 percent increase in RBS' bad debts, soon to be 70 percent owned by the government, would equal £200 billion. This is equivalent to one-third of annual government spending or double the annual spend on the National Health Service.

Not only does the government's blank cheque for the banks stand little chance of rescuing either Britain's banks or the economy, financial commentators are now talking openly about the insolvency of Britain itself. On Tuesday the pound fell to a seven year low against the dollar, hitting $1.3966 from $2 less than a year ago.

Jim Rodgers, who founded the Quantum hedge fund with billionaire speculator George Soros, warned that sterling was "finished" and that investors should dump the pound. Soros and Quantum are credited with forcing sterling's collapse out of the European Exchange Rate Mechanism on September 16, 1992, by selling short more than $10 billion worth of pounds.