Paulson at last goes systemic

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It is much better to be a banker in the US than in the UK. The rescue announced on Tuesday in Washington is significantly more generous than the British equivalent. But it is moot whether US public opinion will be as generous towards the architect of the scheme, Hank Paulson, the US Treasury secretary.

The Paulson scheme has clear echoes of the plan announced in London last week. The US Treasury will buy stakes in nine large banks on terms which are open to other investors. New interbank lending – and more deposits – will be guaranteed by the Federal Deposit Insurance Corporation and the Federal Reserve will finalise a new, broader liquidity scheme.

There are, however, crucial differences. The US Treasury is being more generous to banks and shareholders than its UK counterpart. The preference shares being bought in the US pay a 5 per cent dividend, rising to 9 per cent after five years. In the UK, these shares will pay at 12 per cent. And unlike in the UK, participating US banks will be able to pay dividends, albeit subject to Treasury approval. The US authorities are, perhaps, being kinder to bankers than is politically prudent.

The UK scheme takes into its net the bulk of its more compact banking system, whereas the US plan, dealing with a larger and more fractured system, is focused heavily on a few core institutions. The large number of US financial firms outside the conventional banking sector will be supported by the Federal Reserve's offer to buy commercial paper. This is dramatic but follows the logic of Walter Bagehot's advice that lenders of last resort should replace paralysed banks during crises, lending as the commercial banks would normally have done.

At long last, the US government is stepping beyond the piecemeal and ad hoc, seeking to tackle a systemic crisis with a systemic solution. Unlike his UK counterparts, however, Mr Paulson will probably win little praise for this action.

In some measure, this is his own fault. He was slow in bringing forward a coherent plan and the proposals he did release – a $700bn toxic asset dump – were incomplete. Indeed, Mr Paulson only has the powers he is now exercising because Democratic legislators – notably Senator Chris Dodd and Representative Barney Frank – insisted he should.

But he has looked weaker than other finance ministers because he undoubtedly is. He had no choice but to push legislation through a hostile Congress, with all the public horse-trading that entails.

Now Mr Paulson has the opportunity to seize the initiative. In particular, he must soon say what he intends to do with the rest of his $700bn kitty – and whether he thinks it enough. The world economy is still caught in a nasty slowdown, but this plan significantly improves the chance that it will not be too prolonged.