How to privatize RBS [1]

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With Mervyn King saying yesterday that we ought to get on with re-privatising RBS, the issue becomes how to do it.

As we discovered in the 1980s privatisations, you have to take out all the bad and unsaleable bits of a business before people will buy it. For example, the highly-risky nuclear element had to be taken out of the electricity sale. Likewise we need to pull out ABN-Amro. And to set up a 'bad bank' and put into it all the toxic business of RBS, and for that matter, Lloyds TSB too. That would free up lending and crystallize or segregate the banks' zombie obligations. It takes a bit of time to root everything out, but there is plenty of international expertise around to help.

Should RBS and Lloyds RSB be split into retail and investment arms? After the Vickers Report this idea is wearing the yellow jersey, but retail banks are not inherently safer than mixed ones, as Northern Rock and others showed. It is also hard to define the retail/investment boundaries. A split like this would just slow the process down.

While we are setting up the bad bank, it seems sensible to split the banks so as to promote competition and reduce systemic risk. Lloyds TSB could be split into Lloyds, Halifax and BoS. RBS could be split into NatWest and RBS, or into smaller pieces. That again would take time, and would mean re-engineering some back-office systems (most of which, in RBS's case, are hopelessly outdated anyway), but it gets rid of the 'too big to fail' problem.

How then to privatise? We could just give out shares to taxpayers, since they were the ones who stumped up for the bailout. But nearly everyone is a taxpayer, paying VAT and other indirect taxes, and it would be controversial to give out more shares to people earning enough to pay more tax than others. So what about giving out shares to everyone? Well, the mess of Russia's 'voucher privatisation' suggests that is a bad idea. People just sell their shares on right away, probably for too little money, and conventional owners step in.

But share giveaways raise no money on what should be a valuable asset. So a better route is to sell the banks and then distribute the proceeds to everyone. A staged sale would help to maximise the returns, and people would get several cheques, not just one. Perhaps some of the proceeds could be returned to the public and some could be put to paying off the national debt.

A broad privatisation is preferable, as selling to another bank just re-concentrates risk. Of course, it might be possible to sell to a completely different outside player ? an Asian bank, for example ? but people are nervous about foreign ownership.

And a popular privatisation bonanza just before the 2015 election could give Osborne and Cameron quite a boost ? which I am sure enters their calculations.

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