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A Bailout We Don't Need

By James K. Galbraith
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Now that all five big investment banks -- Bear Stearns, Merrill Lynch, Lehman Brothers, Goldman Sachs and Morgan Stanley -- have disappeared or morphed into regular banks, a question arises.

Is this bailout still necessary?

The point of the bailout is to buy assets that are illiquid but not worthless. But regular banks hold assets like that all the time. They're called "loans."

With banks, runs occur only when depositors panic, because they fear the loan book is bad. Deposit insurance takes care of that. So why not eliminate the pointless $100,000 cap on federal deposit insurance and go take inventory? If a bank is solvent, money market funds would flow in, eliminating the need to insure those separately. If it isn't, the FDIC has the bridge bank facility to take care of that.

Next, put half a trillion dollars into the Federal Deposit Insurance Corp. fund -- a cosmetic gesture -- and as much money into that agency and the FBI as is needed for examiners, auditors and investigators. Keep $200 billion or more in reserve, so the Treasury can recapitalize banks by buying preferred shares if necessary -- as Warren Buffett did this week with Goldman Sachs. Review the situation in three months, when Congress comes back. Hedge funds should be left on their own. You can't save everyone, and those investors aren't poor.

With this solution, the systemic financial threat should go away. Does that mean the economy would quickly recover? No. Sadly, it does not. Two vast economic problems will confront the next president immediately. First, the underlying housing crisis: There are too many houses out there, too many vacant or unsold, too many homeowners underwater. Credit will not start to flow, as some suggest, simply because the crisis is contained. There have to be borrowers, and there has to be collateral. There won't be enough.

In Texas, recovery from the 1980s oil bust took seven years and the pull of strong national economic growth. The present slump is national, and it can't be cured that way. But it could be resolved in three years, rather than 10, by a new Home Owners Loan Corp., which would rewrite mortgages, manage rental conversions and decide when vacant, degraded properties should be demolished. Set it up like a draft board in each community, under federal guidelines, and get to work.

The second great crisis is in state and local government. Just Tuesday, New York Mayor Michael Bloomberg announced $1.5 billion in public spending cuts. The scenario is playing out everywhere: Schools, fire departments, police stations, parks, libraries and water projects are getting the ax, while essential maintenance gets deferred and important capital projects don't get built. This is pernicious when unemployment is rising and when we have all the real resources we need to preserve services and expand public investment. It's also unnecessary.

What to do? Reenact Richard Nixon's great idea: federal revenue sharing. States and localities should get the funds to plug their revenue gaps and maintain real public spending, per capita, for the next three to five years. Also, enact the National Infrastructure Bank, making bond revenue available in a revolving fund for capital improvements. There is work to do. There are people to do it. Bring them together. What could be easier or more sensible?

Here's another problem: the wealth loss to near-retirees and the elderly from a declining stock market as things shake out. How about taking care of this, with rough justice, through a supplement to Social Security? If you need a revenue source, impose a turnover tax on stocks.

Next, let's think about what the next upswing should try to achieve and how it should be powered. If the 1960s were about raising baby boomers and the '90s about technology, what should the '10s and '20s be about? It's obvious: energy and climate change. That's where the present great unmet needs are.

So, let's use the next few years to plan, mapping out a program of energy conservation, reconstruction and renewable power. Let's get the public sector and the universities working on it. And let's prepare the private sector so that when the credit crunch finally ends, we'll have the firms, the labs, the standards and the talent in place, ready to go.

Some will ask if we can afford it. To see the answer, don't look at budget projections. Just look at interest rates. Last week, in the panic, the federal government could fund itself, short term, for free. It could have raised money for 30 years and paid less than 4 percent. That's far less than it cost back in 2000.

No country in this situation is broke, or insolvent, or even in much trouble. For once, Wall Street's own markets speak the truth. The financially challenged customer isn't Uncle Sam. He's up on Wall Street, where deregulation, greed and fraud ran wild.

James K. Galbraith is the author of "The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should Too."

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