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OP-ED COLUMNIST

The Big Dither

By PAUL KRUGMAN

Last month, in his big speech to Congress, President Obama argued for bold steps to fix America's dysfunctional banks. "While the cost of action will be great," he declared, "I can assure you that the cost of inaction will be far greater, for it could result in an economy that sputters along for not months or years, but perhaps a decade."

Many analysts agree. But among people I talk to there's a growing sense of frustration, even panic, over Mr. Obama's failure to match his words with deeds. The reality is that when it comes to dealing with the banks, the Obama administration is dithering. Policy is stuck in a holding pattern.

Here's how the pattern works: first, administration officials, usually speaking off the record, float a plan for rescuing the banks in the press. This trial balloon is quickly shot down by informed commentators.

Then, a few weeks later, the administration floats a new plan. This plan is, however, just a thinly disguised version of the previous plan, a fact quickly realized by all concerned. And the cycle starts again.

Why do officials keep offering plans that nobody else finds credible? Because somehow, top officials in the Obama administration and at the Federal Reserve have convinced themselves that troubled assets, often referred to these days as "toxic waste," are really worth much more than anyone is actually willing to pay for them — and that if these assets were properly priced, all our troubles would go away.

Thus, in a recent interview Tim Geithner, the Treasury secretary, tried to make a distinction between the "basic inherent economic value" of troubled assets and the "artificially depressed value" that those assets command right now. In recent transactions, even AAA-rated mortgage-backed securities have sold for less than 40 cents on the dollar, but Mr. Geithner seems to think they're worth much, much more.

And the government's job, he declared, is to "provide the financing to help get those markets working," pushing the price of toxic waste up to where it ought to be.

What's more, officials seem to believe that getting toxic waste properly priced would cure the ills of all our major financial institutions. Earlier this week, Ben Bernanke, the Federal Reserve chairman, was asked about the problem of "zombies" — financial institutions that are effectively bankrupt but are being kept alive by government aid. "I don't know of any large zombie institutions in the U.S. financial system," he declared, and went on to specifically deny that A.I.G. — A.I.G.! — is a zombie.

This is the same A.I.G. that, unable to honor its promises to pay off other financial institutions when bonds default, has already received $150 billion in aid and just got a commitment for $30 billion more.

The truth is that the Bernanke-Geithner plan — the plan the administration keeps floating, in slightly different versions — isn't going to fly.

Take the plan's latest incarnation: a proposal to make low-interest loans to private investors willing to buy up troubled assets. This would certainly drive up the price of toxic waste because it would offer a heads-you-win, tails-we-lose proposition. As described, the plan would let investors profit if asset prices went up but just walk away if prices fell substantially.

But would it be enough to make the banking system healthy? No.

Think of it this way: by using taxpayer funds to subsidize the prices of toxic waste, the administration would shower benefits on everyone who made the mistake of buying the stuff. Some of those benefits would trickle down to where they're needed, shoring up the balance sheets of key financial institutions. But most of the benefit would go to people who don't need or deserve to be rescued.

And this means that the government would have to lay out trillions of dollars to bring the financial system back to health, which would, in turn, both ensure a fierce public outcry and add to already serious concerns about the deficit. (Yes, even strong advocates of fiscal stimulus like yours truly worry about red ink.) Realistically, it's just not going to happen.

So why has this zombie idea — it keeps being killed, but it keeps coming back — taken such a powerful grip? The answer, I fear, is that officials still aren't willing to face the facts. They don't want to face up to the dire state of major financial institutions because it's very hard to rescue an essentially insolvent bank without, at least temporarily, taking it over. And temporary nationalization is still, apparently, considered unthinkable.

But this refusal to face the facts means, in practice, an absence of action. And I share the president's fears: inaction could result in an economy that sputters along, not for months or years, but for a decade or more.