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EDITORIAL

Watershed

There are good reasons to hope — and believe — that the Federal Reserve will ably manage the turmoil in the financial markets. Its surprise lending rate cut on Friday and earlier infusions of cash into the banking system show that it is committed to crisis management.

But the Fed's moves also show that it believes the markets' problems have become a threat to the broader economy. For that reason, calming the markets should be seen as only a necessary first step toward addressing much bigger issues — issues that President Bush and his aides continue to deny.

The real work — that of leaders, not managers — is to understand how the economy became so vulnerable to current global market instability, and to articulate an agenda for reducing those underlying weaknesses. There is no return to "normal" that would not be the same as sticking one's head back in the sand.

The bare facts are that the nation — heavily indebted — needs to attract some $800 billion a year from abroad, either by borrowing the money or by selling American assets. No serious analyst believes that an imbalance of that magnitude is sustainable.

In fact, the erosive effects are already evident. Debt must be repaid by sending money abroad, leaving less to invest domestically. Selling off American assets means reduced investment returns to Americans. And that's if things go smoothly. Ever present is the risk that the vital foreign inflows will wane, with severe repercussions on interest rates and the dollar.

So far, however, the Bush administration has shown no awareness that the current market turmoil is layered on top of deeper vulnerabilities that demand attention. It cannot even see that the current market upheaval calls for new policies. In an interview this week in The Wall Street Journal, the Treasury secretary, Henry Paulson, said that the credit crunch tied to risky mortgage-related investments was "inevitable." But the credit squeeze is not the work of an invisible hand. It stems from a markets-above-all ideology espoused at the highest levels of government, and resulting regulatory failures in the face of excessive risk taking.

Despite the current turmoil's clear roots in unbridled risk, Mr. Paulson told The Journal, "there is nothing, in my judgment, that we should be doing to ...restrain risk taking." He should tell that to the hundreds of thousands of people who will endure foreclosure because of reckless lending, which spawned the risky investments now roiling the markets.

In Mr. Paulson's world, and President Bush's, excess and its ruinous consequences are the natural result of market activity, which is itself sacrosanct. So it will fall to Congress and the presidential candidates to put the truly pressing issues on the agenda. The nation badly needs progressive, pro-market leaders who will advance a legal and regulatory framework to reduce excesses in lending and derivatives and to monitor opaque market actors, like hedge funds and private equity firms. The goal must be to avert or at least mitigate crises that otherwise do damage far beyond the immediate investors.

And to succeed in the future, the country must first stop digging the hole it is in. That will require federal budget discipline, especially health care reform and higher taxes.

It will also require higher private savings. And all of that will require leaders who will level with Americans about the depth of the country's economic problems, including its vulnerability to global turbulence, and the sacrifices it will take to address them.

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