Insight

Bailout Nation

APRIL 16, 2010

The American people don’t like bailouts, unless it is they themselves who are getting bailed out. And even then, being bailed out leaves a bitter taste in one’s mouth.

TARP has popularly been described as a bailout, and maybe it was. But without TARP, the financial system would have completely crashed, and believe me, millions of Americans would have come to the government, asking for their own personal bailout.

America, as a society, has been over-leveraged. The federal government is over-leveraged. Investment houses were over-leveraged. Most consumers were over-leveraged.

What does that mean? It means they were buying stuff that they couldn’t afford. The government was buying a prescription drug bill, two wars, and a bunch of other stuff, including now a new health care bill, without either getting more revenue or cutting spending elsewhere.

Investment houses were making huge bets with little money to back up the bets. And they were betting that the housing market would continue to rise for the rest of history. In some cases, these smart investors were betting 40 bucks for every one dollar they had in the bank. And they were making stupid bets. These are the geniuses that we entrust with all of our pension funds and retirement savings.

And we all know about consumer debt. People just kept putting stuff on their credit card until they couldn’t make the minimum payments, and then they got another credit card, (which they could do fairly easily, because the banks let them – and encouraged them – to do exactly that), and so on until they ran out of credit cards to get and then they declared bankruptcy. You can make the case that the banks, precisely because they were so stupid and so reckless and so greedy, deserve what they got, and in a perfect world that would be true, but the sad fact is that as long as these banks have savings and checking accounts that are guaranteed by the government, we are all on the hook as taxpayers.

And so, we have a situation now, where the federal government is about ready to go broke, the investment houses either went broke or got huge help from the government that is about ready to go broke, and many consumers have already gone broke and have been kicked out their houses. Many of these consumers have gone to the federal government, which is about ready to go broke, for help, either through mortgage relief or extended unemployment insurance, because not only did they get kicked out of their houses, but in many instances, they lost their jobs.

The people who are the angriest are those suckers who paid their bills on time, didn’t get themselves overleveraged, played by the rules, and now have this sickening sense that they are going to have to pay to bail out everybody, including the federal government, the Wall Street investment houses, the banks and their neighbors who were living the high life and now are asking the government for their own personal bailouts.

I am in no way an expert on the financial industry. I have two degrees in history, and although I did work for a

half a decade at a Chicago-based commodities firm, I have little background in high finance. I don't know the difference between a credit default swap or a C.D.O., all of these complicated derivatives make my head spin, and the ways of Wall Street remain mostly a mystery to me.

But I have read a few books on the subject. I read Aaron Sorkin's "Too Big To Fail." I read Michael Lewis's "Liar's Poker" and "The Big Short." And I am reading Hank Paulsen's book, "On the Brink," so I think I have a pretty good handle on what happened over the last several years, at least from a historic perspective.

And it makes me feel somewhat better that I am not the only one who doesn't understand some of these more complicated derivatives. From what I read in these books, most of these so-called brilliant CEO's of these investment houses didn't really understand them either.

Which could explain why we got in some of the mess that we got into in the first place.

One fiction that needs to be cleared up is that Republicans tend to be the party of Wall Street. That is simply not the case. The biggest Congressional advocates on behalf of Wall Street are Chuck Schumer and Rahm Emanual. The guys who set up the current Wall Street rules that allowed these investment houses to run wild were Bob Rubin, Larry Summers and Tim Geithner, who were at the time working for the Clinton Administration. Most of these Wall Street titans give substantial amounts of money to the Democrats, and vote mostly for Democrats.

Republicans happen to have a free market philosophy, which contains an important element called moral hazard. If you screw up, you lose money. Democrats, by their very nature, abhor moral hazard. They are always trying to give the people in society who screw up a second break. Wall Street loves the free market when things are going well. But when things crash, well, that is when they come to government begging for help.

That is what I have learned from the previously mentioned books, that when things started going south, the CEO of Lehman Brothers, Bear Stearns, Goldman Sachs, etc, were desperate to get government bailouts. They promised financial Armageddon if the government didn't step. And maybe they were right, but it doesn't seem to me that any of these financial barons suffered personally from this crash. They seem to all be doing pretty well for themselves, even today, even after they completely screwed up our economy with their big bets (backed ultimately by the government) which all seemed to go desperately wrong.

Doug Holtz-Eakin, President of the American Action Forum, has some good suggestions about what should be included in an effective Wall Street oversight bill, in an article in Politico today (www.budurl.com/k3zd).

To those, I would add three more.

1) Fix the ratings agencies: The biggest fraud was perpetrated by Moodys and other ratings agencies which assigned a Triple A rating to bonds that weren't worth the paper they were written on. I don't know what happened there, but their incompetence helped lead to the Great Recession.

2) Require Transparency: Investors have a right to know what is going on the financial world, and investment houses have a duty to provide complete transparency.

3) No bailouts for gamblers: We have an insurance program so that when depositors put their money in a bank, they have an expectation that that money will be gettable, even if the bank fails. That makes sense to me. But that kind of insurance should not be extended to investment bankers who gamble with that money. I am all for

the free market and I am all for insurance protection for depositors. What I am not for is another bailout for firms like Goldman-Sachs and the rest of them, who gamble heavily when times are good, but then come running to the government when times are rough.

The American people are understandably upset about the notion of more bailouts, especially those of us who played by the rules and were responsible with our money. Obviously, the same can't be said for the politicians and the Wall Street tycoons who put our nation on the financial brink and still may push us over.

From the Feehery Theory