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Reverse the vote or risk another Great Depression

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Guest essayist

I've learned to never discount the role of luck. It is particularly bad luck that the current financial crisis has come to a head barely a month before a major election (it's called the "silly season" for a reason). Fears of a voter backlash have apparently killed, at least temporarily, the distasteful but necessary $700 billion bailout.

That the economy is at some peril is apparent.

Debt is the grease that keeps the economy moving. There can be too much debt, to be sure, but some level of continuous borrowing is perfectly normal and healthy.

Most businesses — particularly small ones — make their money by leveraging borrowed cash. They borrow to buy inventory (if they are a retailer) or materials (if a manufacturer) or simply to hire staff (if they are a service firm) so they can resell the inventory to customers, deliver an order or provide a service.

The willingness of banks and other institutions to lend and of businesses to borrow is dependent on stable expectations about the future — this is part psychology, part economics. Psychology or not, it is real and has very significant implications for the economy. Credit markets came close to shutting down the week Lehman Brothers collapsed and the Fed dealt with mega-insurer AIG. The principal goal of the bailout plan is to restore stable expectations to credit markets.

What are the consequences of doing nothing? Neither Ben Bernanke at the Fed nor Henry Paulson at Treasury can tell us with any certainty. In fact, uncertainty pretty much sums up the whole problem.

If we knew, for example, what all these complex mortgage-backed securities were truly worth, we probably wouldn't need a bailout. The role of the bailout is to provide some assurance that there *is* a floor to the value of these securities, a floor established by the bailout entity. Yes, we could get away with doing nothing and letting the markets sort things out. Personally, I would rather not take that risk.

Yes, $700 billion is a lot of money, but it is possible, even likely, that the final cost will be less. Functionally, the bailout is intended to buy securities that are backed by mortgages on real houses. The worst case is that homeowners default on the loans and the cost truly is $700 billion. The most likely outcome is that they have some value and the cost is less. It is also quite possible that mortgages are actually worth $700 billion or more and the bailout costs little or nothing over time.

Firms holding these assets have been writing down their values every quarter for the better part of two years. Even if we purchased them at the value they now hold "on the books," they are still far below their original value.

We remain a wealthy country. This is something we can afford. Our national debt as a share of GDP is modest by historical standards.

If this vote is not reversed, the consequences could be serious and prolonged. To date, the tremendous turmoil on Wall Street has not had a major impact on ordinary citizens — we may talk of the Great Depression, but we have not experienced anything remotely like those terrible years.

Let us hope we won't have to.

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