

OH FINANCIAL CRISIS, YOU ARE SO DEPRESSING.

by Tim Fernholz

Today the Fed [announced](#) it would start buying commercial paper, the short-term business loans that keep most companies running smoothly. The Fed's decision indicates its worry that the credit crunch is so severe that there would be no market at all for most businesses to find short-term credit. I spoke with two economists today, EPI's [Josh Bivens](#) and NDN's [Rob Shapiro](#) to get a sense of what's going on.

On the decision to buy commercial paper, Bivens said,

"It's not how you want the economy to operate all the time, but it's a much more direct stab at the problem than the bailout bill was. We do have a real serious financial crisis going on; given the Fed's action today, it's hard for me to see how it gets much worse. I don't see the Fed going in and buying commercial paper directly unless they're really convinced it's ground to a halt. It's requiring the federal government to become the financial sector, to become the credit market, and that to me is the worst case scenario. We've probably kind of hit bottom.

If you just restrict yourself to the job market, which is most relevant to the most people ... I think we'll probably have fewer jobs than we had in January of 2008 two years from now, so I think we're in [for] another year and a half of outright job loss. We will start adding jobs and closing that gap just painfully slowly. If you look at the last two recessions, we had job loss that went well after the official end of the recession. Given that this is so much worse, it would be hard for me to believe that we don't see 2 to 3 years of outright job loss."

Shapiro was more pessimistic:

We are probably in the deepest recession of our lifetimes, and it's going to get a lot worse. The singular feature of this crisis is that no one knows the condition of the securities held by any institution and consequently across the financial center. That's the reason why we have a serious credit problem today ... banks won't lend to other banks or financial institutions because they don't know how much bad paper they are holding. The Fed is trying, it's putting as many fingers as it can in the dike. The market for this kind of paper has declined very sharply, so they are willing now to purchase it in order to avoid large-scale bankruptcies.

Consumers, consumption spending was falling at a 3 percent annual rate in the third quarter ... you're talking about a third quarter that looks like it is contracting at a rate of about 2 percent. That's before this crisis affects investment and consumption. ... Europe is in a recession, and Europe is our single largest export market. There are only three sources of demand, consumers, business, and foreigners, so that takes out the third.

Neither man was particularly optimistic about the bailout bill's main function, TARP (Troubled Assets Relief Program). Shapiro placed a stress on transparency as a solution to financial panics, urging the Fed, FDIC and associated agencies to immediately begin identifying and publicizing which banks have sound assets and which do not. Bivens emphasized the importance of encouraging the Treasury department's new TARP Czar, [Neal Kashkari](#), to choose the best

options from the menu of choices that Congress authorized, especially favoring the use of equity stakes over reverse auctions for dealing with toxic assets whose value is based on housing prices.

Both agreed on the need for an immediate stimulus legislation, with Shapiro suggesting a \$200 billion investment focused on infrastructure that accomplishes energy goals, such as updating the electricity grid or building light rail. Bivens emphasized expanding "safety net programs" like unemployment insurance and food stamps, which have immediate affects, and then moving on to infrastructure needs that can be quickly identified and tackled, such as school construction. Shapiro also noted that there is a critical long-term goal to be addressed in terms of deficit reduction in the next five to six years:

"I have not been one who has thought the deficit is a serious problem at this point because the globalization of capital means you can always borrow. [But] our fiscal outlook is worsening so much, this and the bailout and the structural issue we have of boomers retiring, and the long-term impact of this crisis on global confidence in the U.S. economy ... we could have problems with people buying our T-bills. I'm not talking about cutting the deficit next year, I'm talking about putting in place policies that significantly increase revenues and reduce the rate of growth of entitlement spending ... over the next five years. [The problem is] the combination of an accelerating deficit with declining confidence in the dollar and the U.S. economy by those who have to fund it, which is not us."

The politics of a future stimulus bill seem difficult, to say the least, although a lame-duck Congress might be the best bet for passing the necessary increase in spending. Fed Chair **Ben Bernanke** also [said](#) later in the day that his institution would continue it's ad-hoc approach to holding up the economy and hinted at lower interest rates by the end of the month. With economic indicators continuing to lag, action has to be taken, as the Fed showed today, to keep the economy from moving from worse to worst.

-- *Tim Fernholz*