

Between A Rock And A Hard Place

By Thomas B. Edsall, Political Editor, Huffington Post

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The decision by the Bush and Obama administrations to use taxpayer money to prop up troubled financial institutions has produced a growing populist outcry that threatens to undermine the administration's ability to win Congressional approval for future legislation to counter the recession, and/or to win approval for the record-setting \$3.55 trillion 2010 budget proposed by Obama on February 26.

In effect, the Obama administration has tied itself to a policy that shows every sign of becoming an inexorably-tightening hangman's noose around the president's neck.

Not only does public anger over the current bailout strategy threaten the administration's executive authority, but it also carries the political risk of linking the White House to the now-loathed Wall Street establishment.

Democrat Robert Shapiro, former Under Secretary of Commerce for Economic Affairs during the Clinton administration, and chairman of the economic advisory firm [Sonecon](#) argues that, by generally deferring to Wall Street leaders, the administration has become the target of populist resentment, drawing attention to the fact that many in the administration came from the financial industry, or the New York Fed -- which is closely linked to the industry, including Larry Summers and Tim Geithner. Now, Shapiro added, [Summers](#) and [Geithner](#) are in position of virtually defending Wall Street - only backing off on the AIG bonus issue, for example, when the public rose up in fury.

Shapiro argues strongly in favor of temporary nationalization of those banks which are on the verge of collapse. A full scale, short-term takeover of insolvent institutions "is the only reasonable course at this point," he said, if that means "pulling out the bad assets and the leveraged borrowed to hold them (without having to put a particular value on them), and selling what's left to a new group, under a new name or the old one. It could actually be done very quickly - so the institution is closed for a short time while the depositors' accounts are quickly transferred to the new entity."

Shapiro contends that "these institutions are so stricken that there's no other practical solution."

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There is a clear political advantage to a nationalization strategy, some argue: nationalization would penalize the banks, stockholders, and, depending on how the remaining assets are dealt with, bond holders - not, in theory, the general taxpaying public, eliminating the perception that the Obama administration is acting in league with Wall Street to the disadvantage of Joe and Jill Six-pack.

Harvard economist Richard Freeman's comments to Huffington Post reflect concern over the liabilities of the Obama administration's recent policies: "What most bothers me is that it looks as if the dead hand of Wall Street is still calling the shots. The President needs to hear from more critical folks, from the left and right, from the financial community, and from outside it, instead of folks who seemingly cannot envision a different sort of capitalism than the one that has just imploded."

Like Shapiro, Freeman suggests that the administration consider a more aggressive tack:

"I don't understand why they are afraid to follow the proven path of Sweden of nationalizing some banks, have civil servants or newly-hired folks run them and then turn them back to the private sector when they are again profitable, or in allowing some of the banks or firms to fail also, as some right-wing guys want. I doubt that AIG going belly-up would really be the end of the economic universe, as they seem to fear. They have not provided any evidence for that. They have not even shown that the money we have provided through TARP has done much good."

Nassim Taleb, author of "[The Black Swan](#)" and one of the few economists who anticipated the crisis, noted in a Huffington Post interview that the political liabilities of current administration bailout measures are double-edged -- that not only do the bailout funds reward the villains, but, by using public money, bailout appropriations force taxpayers who have played by the rules to pay the costs of others' failings.

"I mind when the government punishes people [who have shown] good discipline," he said, noting that the effect of current administration policy is to "privatize the gains and socialize the losses." Taleb is a strong proponent of [bank nationalization](#).

Cornell economist Robert Frank, author of "Microeconomics and Behavior and The Winner-Take-All Society", in an exchange with the Huffington Post, voiced a more cautious, but by no means negative, assessment of nationalization:

"The bank bailout is a real conundrum. The people at CITI and Goldman Sachs were buying mortgage-backed bonds and then hedging them with AIG credit-default swaps [that] they had to know couldn't be honored by AIG in the one circumstance in which they'd be needed--namely, a sharp decline in housing prices. CITI and Goldman were making bundles of money on these bonds while the party lasted. Now I'm being taxed to pay for AIG bailout funds that get passed through so that CITI and Goldman lose not one penny on them. If these firms could be taken over without causing the global financial meltdown some warn about, I'd be for it in a heartbeat. Of course, a lot of smart people are calling for such a takeover, but some other smart people are warning against it. If I had to choose, I'd do it. But I know far too little about the ins and outs of global finance to have much confidence in that judgment. So, yes, Obama's in a tough position."

There is a major, ongoing debate over the pluses and minuses of nationalization. Critics of nationalization make the case that: a) the sheer size and complexity of the U.S. banking sector will overwhelm government managerial and [regulatory resources](#); b) the scope of the undertaking will surpass the limitations and competencies of government bureaucrats; c) politicians with no expertise in high finance are ill-equipped to make banking sector decisions

involving billions or trillions of dollars, and will inevitably seek to further their own parochial interests; d) there will be unintended consequences stemming from the competitive disadvantages of troubled banks not chosen for nationalization; and e) the government may fail to quickly transfer or sell reorganized banks back into the private sector.

One of the sharpest [critics](#) of nationalization is the highly-regarded Princeton economist Alan S. Blinder, a member of President Clinton's Council of Economic Advisers, and a supporter of Obama's presidential bid.

Advocates of nationalization run the ideological gamut from [Alan Greenspan](#) to [Paul Krugman](#).

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Matthew Continetti of the Weekly Standard has a [conservative take](#) on the political dilemma arising from current bailout policy:

"Obama and Congress can fulminate, preen, and retaliate all they want. It won't solve the problem. The problem is that major financial institutions are now on the public dole, and will be accountable to the public as long as they are."

The explosion of rage over the AIG bonuses will make difficult, at best, any future effort to win Congressional approval for additional cash for the Troubled Asset Relief Program (TARP) to assist banks, automobile companies and other beleaguered institutions. The perceived misuse of federal money in bailing out AIG will almost certainly have spillover effects, dampening support for such key Obama initiatives as expanded health care, education, and a shift to green domestic energy sources, all of which will cost hundreds of billions of dollars.

The long-range threat to the Obama administration is a revival of the view widely held in the 1970s and 1980s that Democrats were irresponsible custodians of the public treasury, willing to spend money on wasteful projects, or in behalf of liberal special interest groups. That image was altered by the success of Bill Clinton in overseeing eight years of unparalleled prosperity and growth, eliminating the deficit, and paring back welfare rolls. Republicans, in turn, lost much of their standing as prudent custodians of the nation's wealth by running up immense deficits and presiding over the unfolding of the current economic meltdown.

New York Daily News columnist Michael Goodwin on Sunday [suggested](#) a revival of the Democrats' image problem:

"Obama represents a secular religion that believes, no matter the malady, Washington is the antidote. More government is the chicken soup of his tribe."

Until the 1996 passage of Clinton-sponsored welfare reform, the program was repeatedly used by Republicans to demonize Democratic spending on policies that - as the critics had it -- undermined productivity and incentives for hard work. Now, with trillions of government dollars flowing to failing firms, John Avlon of the Daily Beast [wrote](#):

"Forget welfare queens. We've never seen an entitlement mentality quite like this-where bonuses were not rewards for work well done but guaranteed entitlements written into high-end contracts."

Nobel laureate Paul Krugman, in turn, warned on March 21 in his New York Times [blog](#) that the new Treasury plan to use Federal Reserve money and FDIC insurance to encourage private purchasers of "toxic" bank holdings, which is expected to be announced Monday, represents the victory of "zombie ideas." Krugman ominously added, "when the plan fails, as it almost surely will, the administration will have shot its bolt: it won't be able to come back to Congress for a plan that might actually work. What an awful mess."

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