I want your money

No government bail-out of the banking system was ever going to be pretty. This one deserves support

SAVING the world is a thankless task. The only thing beyond dispute in the $700 billion plan of Hank Paulson, the treasury secretary, and Ben Bernanke, chairman of the Federal Reserve, to stem the financial crisis is that everyone can find something in it to dislike. The left accuses it of ripping off taxpayers to save Wall Street, the right damns it as socialism; economists disparage its technicalities, political scientists its sweeping powers. The administration gave ground to Congress, George Bush delivered a televised appeal and Barack Obama and John McCain suspended the presidential campaign. Even so, as *The* Economist went to press, the differences remained. There was a chance that Congress would say no.

Spending a sum of money that could buy you a war in Iraq should not come easily; and the notion of any bail-out is deeply troubling to any self-respecting capitalist. Against that stand two overriding arguments. First this is a plan that could work (see pages 81-83). And, second, the potential costs of producing nothing, or too little too slowly, include a financial collapse and a deep recession spilling across the world: those far outweigh any plausible estimate of the bail-out's cost.

Mr Market goes to Congress

America's financial system has two ailments: it owns a huge amount of toxic securities linked to falling house prices. And it is burdened by losses that leave it short of capital (although the world has capital, not enough has been available to the banks). For over a year, since August 2007, central bankers, principally Mr Bernanke, have been trying to make this toxic debt liquid. But by September 17th, following the bankruptcy of Lehman Brothers and the nationalisation of American International Group earlier that week, the problem started to become one of the system's solvency too. The market lost faith in a strategy that saved finance one institution at a time. The economy is not healing itself. If credit markets stay blocked, consumers and firms will enter a vicious spiral.

Mr Paulson's plan relies on buying vast amounts of toxic securities. The theory is that in any auction a huge buyer like the federal government would end up paying more than today's prices, temporarily depressed by the scarcity of buyers, and still buy the loans cheaply enough to reflect the high chance of a default. That would help recapitalise some banks-which could also set less capital aside against a cleaner balance sheet. And by creating credible, transparent prices, it would at last encourage investors to come in and repair the financial system: this week Warren Buffett and Japan's Mitsubishi-UFj agreed to buy stakes in Goldman Sachs and Morgan Stanley. Some banks would still not have enough capital, but under Mr Paulson's original plan, the state could put equity in them, or, if they become insolvent, take them over and run them down.

The economics behind this is sound. Government support to the banking system can break the cycle of panic and pessimism that threatens to suck the economy into deep recession. Intervention may help taxpayers, because they are also employees and consumers. Although $700 billion is a lot-about 6% of GDP-some of it will be earned back and it is small compared with the 16% of GDP that banking crises typically swallow and trivial compared with the Depression, when unemployment surged above 20% (compared with 6% now). Messrs Bernanke and Paulson also have done well by acting quickly: it took seven years for Japan's regulators to set up a mechanism to take over large broke banks in the 199os.

Could the plan be better structured? Some economists want the state to focus on putting equity into the banks—arguing that it is the best way to address their lack of solvency. In theory you would need to spend less, because a dollar of new equity would support $10 in assets. Yet the banks might not take part until they were on the ropes and, if house prices later fell dramatically more, the value of the banks' shares would collapse. The threat of the government taking stakes would scare off some private investors. And in the charged atmosphere after this bail-out meddling politicians, as part-owners, would have a tempting lever over the banks.

Mr Paulson's plan also has its shortcomings. He will find it hard to stop sellers from rigging auctions, if only because no two lots of dodgy securities are exactly the same. Taxpayers may thus pay over the odds and banks may be rewarded for their stupidity. Yet these costs seem small against the benefit of putting a floor under the markets. And fine calculations about moral hazard are less pressing when investors are fleeing risk.

If the economics of Mr Paulson's plan are broadly correct, the politics are fiendish. You are lavishing money on the people who got you into this mess. Sensible intervention cannot even buy long-term relief: the plan cannot stop house prices falling and the bloated financial sector shrinking. Although the economic risk is that the plan fails, the political risk is that the plan succeeds. Voters will scarcely notice a depression that never happened. But even as they lose their houses and their jobs, they will see Wall Street once again making millions.

Buckle a little, but do it briefly

In retrospect, Mr Paulson made his job harder by misreading the politics. His original plan contained no help for homeowners. And he assumed sweeping powers to spend the cash quickly. He was right to want flexibility to buy a range of assets. But flexibility does not exclude accountability. As complaints mounted, Mr Paulson and Mr Bernanke buckled—agreeing, for instance, to more oversight. Now that Messrs McCain and Obama have returned to Congress to forge a deal, more buckling may be necessary. Ideally, concessions should not outlast the crisis: temporary help for people able to stay in their houses, a brief ban on dividends in financial firms, even another fiscal package. They should not be permanent or so onerous that the programme fails for want of participants-which is why proposed limits on pay are a mistake (see next leader).

Mr Paulson's plan is not perfect. But it is good enough and it is the plan on offer. The prospect of its failure sent credit markets once again veering towards the abyss. Congress should pass it—and soon. •

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