Policy Memorandum

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# Bailout plan must help the middle class and grow the economy

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Congress is currently haggling over an agreement to bail out the financial markets. While a final agreement is still up in the air, we must not forget than inaction is not an option. Without action to shore up the banking system, financial markets may very well freeze up, stalling the overall economy. And without action to spur job creation and support working people, the labor market will freeze and fundamental economic weaknesses will continue.

Far from being an unforeseeable natural disaster, the current financial crisis is a predictable outgrowth of excessive risk-taking, regulatory failure, and lack of accountability in corporations and government. Unfortunately, we are now in a position of having to act to lower the risk of  a global market meltdown.

The administration's initial proposal to shore up the markets was offensive; it essentially asked for a $700 billion blank check for the Treasury secretary with no oversight, no review, and no transparency. Members of Congress this weekend hammered out a better version that includes taxpayer protections, transparency requirements, and government oversight, as well as provisions that will begin to provide assistance to homeowners. Far from ideal, it nevertheless could have been a step forward if Congress had enacted it.

Many of the added safeguards lack teeth and the bill would give excessive discretion to the Treasury secretary. Vigilant congressional and external oversight would be critical to ensure that taxpayers were not taken for a ride by Wall Street.

Coupled with renegotiation in bankruptcy of homeowners' mortgages and other measures to keep people in their homes, direct recapitalization of troubled banks and financial institutions by federal government purchase of preferred stock—rather than buying toxic assets—would better protect taxpayers and prevent unjust enrichment of negligent executives and investors.

Nevertheless, given the ideology of the president and the current Congress, this bailout package might represent the best chance to stop an impending financial meltdown and help prevent substantial fallout to production and employment.

In any event, Congress must also act to prevent future crises. Stronger oversight and financial regulations are needed to prevent instabilities from arising again. A reformed regulatory regime would include additional capital requirements, limits to leverage, streamlined agency oversight, and stronger actions to prevent and punish market manipulation. With modern financial institutions branching into ever new and different activities, regulatory policy should also be constructed to guide financial activities, rather than targeting only certain kinds of institutions.

Congress and the public must recognize that no financial bailout will be enough to prevent a deepening downturn in the economy. Working families were struggling with recessionary conditions well before this crisis, and even with a bailout, these conditions will worsen before they improve.

Congress should address Main Street economic problems by passing a second stimulus package that includes direct job creation through infrastructure repairs and investments, relief for hard-pressed state governments, food stamp and heating assistance, and additional help for the long-term unemployed. The $50 billion package debated last week was far from sufficient. The problems require intervention on the order of $200-300 billion to be spent over the next 18 months.

It is impossible to know at this point the ultimate cost that taxpayers would bear from the bailout. The Treasury would eventually sell the assets it buys with today's borrowed money and could even turn a profit. The latest version also required the president to submit a proposal to recoup losses (if any) from financial firms, and it is important that this be done.

Regardless of whether that happens, it is critical that the money being thrown at failing financial institutions not constrain our ability to fund essential investments in renewable energy, early childhood education, health care, and infrastructure.

Among other things, this crisis highlights the importance of economic policies that help the middle class and grow the overall economy—which is now smaller than it was at the end of 2007. Jobs are being lost each month, causing unemployment to keep ratcheting upward. We cannot maintain economic strength by enriching only financiers and CEOs, by failing to invest in our domestic manufacturing industries, or by squeezing the wages and incomes of average working Americans.