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A stimulus that won't sink the U.S.

Three keys: A package has to be tough, temporary and self-reversing.

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WASHINGTON - These days, a modern depression seems almost within the realm of possibility. To avert this, we need an enormous, immediate stimulus. But unless it's well designed, it may not pass Congress; it may not achieve its objectives; or worse, it may sow the seeds of a disastrous decline in the dollar's value.

That's why the stimulus should be tough, temporary, and reversible. Federal dollars should be extended to private interests only on the toughest terms. Taxpayers should demand the highest yield, the largest equity upside, and the strictest limits on executive compensation and perks.

Being tough on those we bail out offers three important advantages. First, it increases public support, which we'll need to enact huge stimulus expenditures. The public is currently focused on executive compensation and perks, but it will need to focus soon on the value of the securities the Treasury is receiving, including warrants – stock options that would allow taxpayers to cash in on a rebounding company's success.

Second, by being tough on those obtaining bailouts, we can limit the number of companies seeking a bailout. If executives see the federal government as a source of easy, cheap money, why wouldn't they – and every other company – attempt to get a bailout? The government does not have that kind of money.

Third, getting a good deal on our investments will minimize the eventual increase in the federal debt, and the burden it poses to succeeding generations. Many of those companies receiving bailout funds will still go bankrupt, so we must generate profits on those that do not. We need to look at both the rate of return on the preferred stock, and the value of the warrants.

It can be done productively: When Warren Buffett invested in Goldman Sachs, he got twice the rate of return and six times the warrants as taxpayers received for a similar investment in the firm.

Meanwhile, Keynesian economics offers a simple, two-part prescription for the difficult times ahead: easy money now, and fiscal and monetary austerity when the economy improves.

The biggest reason not to provide the first half of this prescription is that the metaphorical patient will be unwilling to swallow the second half. How, in good conscience, can I vote for massive economic stimulus now, if I believe that we will not be able to adopt fiscal restraint later?

We in Congress love handing out money, whether it be in tax cuts, tax rebates, tax holidays, tax fiestas, benefit expansions, subsidies, bailouts, infrastructure projects, aid to states, aid to cities, or aid to individuals. Can we count on future Congresses to discontinue and then reverse expansionary fiscal policies?

If we adopt the fiscal stimulus practices the economy needs now, then both our tendencies toward profligacy and legislative inertia will cause us to leave the financial spigot on too long – perhaps permanently. Some members of Congress familiar with the process, and fearful of the result, may oppose opening the spigot at all.

What's likely to happen is that fiscal hawks will prevent us from getting the full measure of economic stimulus we need now, and that advocates of tax cuts and free spending will prevent us from turning off the spigot later. Thus, we could get inadequate stimulus in 2009, and continue that stimulus long after it is necessary, and even until it is harmful.

To avoid this, the stimulus package should be both temporary and self-reversing. The same statutes that provide a massive stimulus should also provide that particular tax increases and expenditure cuts go into effect in 2013, automatically. The statute could provide an automatic, temporary delay in these austerity measures if we fail to achieve 3 percent economic growth in 2012.

Sure, we should fine-tune the program later. But we need to give the upper hand to those who will advocate fiscal responsibility four years from now. If austerity in 2013 is mandated by statute, advocates of fiscal responsibility will have a fighting chance when budgets are negotiated early next decade.

Only if the economic stimulus proposal is tough, temporary, and self-reversing can we be confident that Congress will adopt a proposal that is big enough and fast enough. Only if the stimulus measures are temporary and self-reversing can we also make sure that the actions we take today do not eventually lead to inflation, higher interest rates, a declining dollar, and an enormous increase in federal debt.

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