Why We Must Approve the Financial Rescue Bill

By Tom Tancredo

It is infuriating. It is unfair. It will cost billions of dollars. It is not a pretty picture – but bank bailouts rarely are. Neither are gall bladder surgeries, but they are sometimes necessary.

Many Americans are wondering how we got to this point – and there is plenty of blame to go around: People took out loans they couldn't repay from banks that were happy to make them; and politicians and bureaucrats in Washington, D.C. created a multi-layered thicket of government regulation and accounting rules that encouraged financial institutions to package and repackage mortgage-based investment vehicles until they (like their potential risk) were nearly unrecognizable.

Certainly, borrowers and lending institutions must be more prudent in the future and government regulators must reform our investment rules so they create an incentive for simplicity and transparency instead of complexity and financial gimmickry. And many Americans are justifiably opposed to "rewarding" the financial institutions who hold played such a prominent role in all of this. If the only thing at stake were the private jets and expense accounts of a few Wall Street executives, there would be no debate and no rescue plan. But it is not Wall Street perks that are at risk now, it is Main Street's credit lifeline.

We must not let our impulse to "punish Wall Street" blind us to the serious risk that the current financial crisis now poses to 401k plans, money market accounts, small businesses, and access to credit for millions of small businesses, as well as millions of Americans seeking loans for cars, homes, and college tuition. As one commentator recently noted, letting the banking system fail to teach Wall Street a lesson would be a little like passengers cheering on the sinking of the Titanic in order to punish the captain for not spotting the iceberg.

This crisis in our credit markets is very real, and extends far beyond the New York City skyline.

Making matters worse, terrorists would love nothing better than to strike the United States while our financial system is wobbly. With our banking system on the ropes, a successful terrorist attack could deliver an economic knockout blow that is felt from Wall Street to the West Coast.

Unfortunately, that is where we now find ourselves.

The balance sheets of many financial institutions are being dragged down by mortgage-based assets which they cannot sell. Many of these assets do have considerable value and in the long run will be marketable. But for now, the uncertainty embodied in these toxic loans is creating turbulence and shaking confidence in the financial markets.

The Federal Reserve has stepped in to provide assistance, but as uncertainty and fear has spread, credit lines have dried up as the banking sector tries to increase its reserves of cash in the event that customers begin withdrawing their deposits or liquidating assets. Paradoxically, this has had the effect of exacerbating the problem by further tightening credit and destabilizing consumer confidence – moving us even closer to a point where depositors panic and demand their money.

Even Milton Friedman, the father of modern free-market economics, recognized the gravity of this kind of systemic problem. Friedman noted that when it was faced with a series of bank closings and bank runs in 1930, the federal government *"did little or nothing to provide the banking system with liquidity, apparently regarding bank closings as calling for no special action."* He goes on to point out that although the government *"had ample power to provide the banks with the cash their depositors were demanding,"* it did not, leading to an even larger bank closing epidemic – a debacle that Friedman argued could have been avoided had Washington taken action.

The market is sending us clear warnings that action is needed. With private capital frozen, the government must provide public financing to break the credit logjam and restore investor confidence. In return for this financing, the government can take possession of mortgage-backed investments from these troubled institutions, improving bank balance sheets, calming fears and restoring a sense of stability to the banking system. And in the end, the taxpayer may well recoup some of his investment – or even make a profit by selling these assets sometime down the road.

Democrat politicians may have started this fire by insisting on government support and encouragement for high-risk home loans, but many Republicans played along. And as George Will has pointed out, the public too shares much of the blame for the fairyland environment in which banks, mortgage lenders and borrowers have operated over the past decade.

Yes, we need to have that extended debate on who caused this traffic accident, and how best to avoid pileups in the future – but the first thing we must do is save the accident victim before he bleeds to death.