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OP-ED CONTRIBUTORS

The Economy Is Still at the Brink

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WHETHER at a fund-raising dinner for wealthy supporters in Beverly Hills, or at an Air Force base in Nevada, or at Charlie Rose's table in New York City, President Obama is conducting an all-out campaign to try to make us feel a whole lot better about the economy as quickly as possible. "It's safe to say we have stepped back from the brink, that there is some calm that didn't exist before," he told donors at the Beverly Hilton Hotel late last month.

Mr. Obama thinks that the way to revive the economy is to restore confidence in it. If the mood is right, the capital will flow. But this belief is dangerously misguided. We are sympathetic to the extraordinary challenge the president faces, but if we've learned anything at all two years into the worst financial crisis of our lifetimes, it is that a capital-markets system this dependent on public confidence is a shockingly inadequate foundation upon which to rest our economy.

We have both spent large chunks of our lives working on Wall Street, absorbing its ethic and mores. We're concerned that nothing has really been fixed. We're doubly concerned that people appear to feel the worst of the storm is over — and in this, they are aided and abetted by a hugely popular and charismatic president and by the fact that the Dow has increased by 35 percent or so since Mr. Obama started to lay out his economic plans in March. But wishing for improvement and managing by the Dow's swings are a fool's game. (Disclosure: One of us, Mr. Lewis, was convicted on federal charges of stock manipulation in 1989, pardoned by President Bill Clinton in 2001 and had his lifetime trading ban overturned by the Securities and Exchange Commission in 2006; documents relating to the case can be found at sblewis.net.)

The storm is not over, not by a long shot. Huge structural flaws remain in the architecture of our financial system, and many of the fixes that the Obama administration has proposed will do little to address them and may make them worse. At another fund-raising event, for Senator Harry Reid, President Obama said: "We didn't ask for the challenges that we face. But we are determined to answer the call to meet those challenges, to cast aside the old arguments and overcome the stubborn divisions and move forward as one people and one nation .... It will take time but I promise you, I promise you, I'll always tell you the truth about the challenges we face."

Keeping that statement in mind — as well as an abiding faith in the importance of properly functioning capital markets — we have come up with a set of questions meant to challenge a popular president, with vast majorities in Congress, to find the flaws in the system, to figure out what's being done to fix them and to get to the truth about the difficulties we face as we set out to restore the proper functioning of our markets and our standing in the world.

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Six months ago, nobody believed that our banking system was well designed, functioning smoothly or properly regulated — so why then are we so desperately anxious to restore that model as the status quo? Nearly every new program emanating these days from the Treasury Department — the Term Asset-Backed Securities Loan Facility, the Public Private Investment Program, the "stress tests" of major banks — appears to have been designed to either paper over or to prop up a system that has clearly failed.

Instead of hauling out the new drywall to cover up the existing studs, let's seriously consider ripping down the entire structure, dynamiting the foundation and building a new system that rewards taking prudent risks, allocates capital where it is needed, allows all investors to get accurate and timely financial information and increases value to shareholders and creditors.

As a start, the best-compensated executives at the top of these big banks, hedge funds and private-equity firms should be treated like general partners of yore. If a firm takes prudent risks that pay off, this top layer of management should be well compensated. But if the risks these people take are imprudent and the losses grave, they should expect to lose their jobs. Instead of getting guaranteed salaries or huge bonuses, they should have the bulk of their net worth completely at risk for a long stretch of time — 10 years come to mind — for the decisions they make while in charge. This would go a long way toward re-aligning the interests of these firms with those of their shareholders and clients and the American people, who have been saddled with their risks and mistakes.

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Why is so much effort being put into propping up those at the top of the economic pyramid — the money-center banks, the insurance companies, the hedge funds and so forth — when during a period of deflation like the one we are in, any recovery will come only by restoring the confidence of the people down at the bottom of the pyramid?

Confidence will return only when jobs can be found and mortgage payments are made. Even if Mr. Obama's claim is true that his $780 billion stimulus package "saved or created" some 150,000 jobs, we seem a long way away from the point where those struggling to get by will feel like spending again. What happens when people buy a car once every 10 years instead of once every two or three, especially now that we taxpayers own such a big percentage of the American auto industry?

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Instead of promising the imminent return of good times, why isn't Mr. Obama talking more about the importance of living within our means and not spending money we don't have on things we don't need? We used to be a frugal nation. The president should be talking about kicking our addictions to easy credit, to quick fixes and to a culture of more is better (and Congress's new credit-card legislation, while perhaps eliminating some of the worst aspects of that industry, certainly didn't send the right message about personal finance).

Gas-guzzling S.U.V.'s, cigarette boats, no-income mortgages and private jets should be relegated to the junk

heaps of history, or better yet, put in a museum dedicated to never forgetting the greed and avarice that led us so far astray.

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Why is the morphine drip still in the veins of the financial system? These trillions in profligate federal spending are intended to make us feel better again even though feeling pain, and dealing with it responsibly, would be healthier in the long run. It is time to stop rescuing the banks that got us into this mess. If that means more bank failures on a grander scale or the dismemberment of Citigroup, so be it. Depositors will be protected — up to $250,000 per account — but shareholders, creditors and, sadly, many employees will, for the long-term health of the system, need to feel the market's wrath.

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Is there to be any limit on bailouts? We have now thrown money at the big banks, any number of regional ones, insurance companies, General Motors, Chrysler and state and local governments. Will we soon be bailing out Dartmouth, which just lost its AAA bond rating? Is there no room left for what the Austrian economist Joseph Schumpeter termed "creative destruction"? And what is the plan to get the American people out of all these equity stakes we now own and don't want?

Furthermore, for government leaders to decide who shall live and who shall die in an economic sense opens them up to legitimate charges of crony capitalism and favoritism. We will benefit in the long run from a return to market discipline.

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Why has Mr. Obama surrounded himself largely with economic advisers who are theoreticians and academics — distinguished though they may be — but not those who have sat on a trading desk, made a market, managed a portfolio or set a spread?

In our view, one of the ways out of this economic conundrum is to have experienced traders — not hothouse flowers — design incentives that will encourage the market to have buyers and sellers meet anew around the proper valuations of assets, not some artificial construct of a market propped up by a pliant Financial Accounting Standards Board or government-sponsored programs that appear to be virtually giving money away to hedge funds and private-equity firms so that they will buy assets they would not ordinarily buy. We're not talking about putting the fox in charge of the henhouse, just putting people who know how markets function in the real world into the important seats in Washington.

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Why isn't the Obama administration working night and day to give the public a vastly increased amount of detailed information about what happens in financial markets? Ever since traders started disappearing from the floor of the New York Stock Exchange in the last decade of the 20th century, there has been less and less transparency about the price and volume of trades. The New York Stock Exchange really exists in name only, as computers execute a very large percentage of all trades, far away from any exchange.

As a result, there is little flow of information, and small investors are paying the price. The beneficiaries, no surprise, are the remains of the old Wall Street broker-dealers — now bank-holding companies like Goldman Sachs and Morgan Stanley — that can see in advance what their clients are interested in buying, and might trade the same stocks for their own accounts. Incredibly, despite the events of last fall, nearly every one of Wall Street's proprietary trading desks can still take huge risks and then, if they get into trouble, head to the Federal Reserve for short-term rescue financing.

Here's something that should change in terms of transparency. The most recent price that any stock traded for should be published online in real time for all to see. And the public should have access to a new type of electronic ticker that provides market information in language that all can understand, not just the insiders.

As for those impossibly complex securities that caused so much of the trouble — among them derivatives, credit-default swaps and asset-backed securities — the S.E.C. should have the power to make public all the documentation surrounding these weapons of mass financial destruction, including all data about the current costs of buying and selling them and the cash flow underlying them. We also need widely accessible, real-time reporting of all trades in the bond market. We bet Mike Bloomberg's company could help design such a system for our benefit.

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Why is the government still complicit in making the system ever less transparent, even when it comes to what should clearly be considered public information? For instance, it took more than a year for the Federal Reserve to disclose that it had agreed to pay BlackRock — the huge money manager that is 45 percent owned by Bank of America — and others $71 million in a no-bid contract to manage the $30 billion of toxic assets that JPMorgan did not want when it bought Bear Stearns in March 2008. And that is only one of the five contracts BlackRock has with the government as a result of this crisis — the nature of the other contracts remains secret.

Treasury Secretary Timothy Geithner has made much of financialstability.gov, the Treasury's new Web site dedicated to "transparency, oversight and accountability." But look it over and try to find, for example, just one record of a bona fide credit-default swap, or the names of the hedge-fund and private-equity investors who have participated in the Term Asset-Backed Securities Loan Facility bonanza. It was only a lawsuit filed by a watchdog group that convinced the Treasury to divulge details of former Secretary Henry Paulson's October meeting with the chief executives of the 10 largest Wall Street firms to force them to take money from the Troubled Asset Relief Program. A lawsuit filed last November by Bloomberg News to force the Federal Reserve to reveal the details on more than $2 trillion in loans that went to banks including Citigroup and Goldman Sachs is still pending in federal court.

And what has become of the S.E.C.'s year-old investigation into who made short-dated, out-of-the-money bets in March 2008 hoping Bear Stearns would fail — bets that were suddenly worth millions of dollars when the company did collapse later that month?

Why do we still not know why Mr. Paulson, Mr. Geithner and the Federal Reserve chairman, Ben Bernanke, allowed Lehman Brothers to file bankruptcy last Sept. 15 but then, a day later, saved A.I.G.? Or why last November this trio decided to absorb potential losses on $301 billion of Citigroup's shaky assets, when

conventional wisdom among insiders held that they were worth only $150 billion at best?

Also, before Dick Fuld, Lehman Brothers' chief executive, appeared before the House Committee on Oversight and Government Reform last October, it demanded from company executives boxes of documents about what happened at Lehman and why. Where are those documents?

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Why hasn't President Obama insisted on public hearings over what happened during this financial crisis?

Not a single top executive of a Wall Street securities firm responsible for causing the financial crisis has had the courage or the decency to step forward in front of the cameras and explain to the American people in his own words exactly how and why he allowed his firm to cause the crisis. Both Mr. Fuld and Alan Schwartz, the chief executive of Bear Stearns at the end, in their Congressional testimony blamed the proverbial once-in-a-century financial tsunami. Do they or any of their peers really think this is true?

There may be a way to find out. There is much talk nowadays coming from top bankers — Lloyd Blankfein of Goldman Sachs, Jamie Dimon of JPMorganChase, John Mack of Morgan Stanley and even Ken Lewis of Bank of America — about seeing how quickly they can repay to the Treasury the TARP money Mr. Paulson forced on them. One precondition of their being allowed to repay the funds should be a requirement that each gives a public deposition and explains, under oath, what truly happened and why.

Such a public hearing would be meant only to offer a truthful assessment of the errors in judgment made at each firm and to promote understanding, so that we — somehow — can avoid repeating the same mistakes again. It would not be about indictments. These men should be offered use immunity from prosecution for their honest testimony, but only with a clear understanding that the failure to tell the truth at any point would result in serious legal consequences. The hearing could be complemented by a truth-seeking commission established to hear the accounts of several people who have departed the scene, including, among others, Mr. Paulson, former Treasury Secretary Robert Rubin and former Wall Street chiefs like Mr. Fuld, Hank Greenberg of A.I.G., Sanford Weill of Citigroup, Jimmy Cayne of Bear Stearns and Stan O'Neal of Merrill Lynch. While far removed from their positions of authority, these men have tales to tell about how this crisis got started and why.

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Why are we not looking to change our current civil and criminal racketeering statutes, which are playing a perverse role in investigations of the crisis? Statutes meant to give prosecutors extraordinary powers of seizure before an indictment is handed up, or to impose treble damages, are appropriately used to break up rings of criminal behavior like the Mafia or drug cartels.

But a few clever prosecutors could use such laws to bring charges against people or firms in the financial services industry whose pattern of bad behavior played important roles in the collapse. Such outright seizure of capital or assets through use of the racketeering statutes can do much harm by giving prosecutors an unnecessarily powerful role in our capital markets. There must be a way to keep what is good about the statutes and to make sure they are not used for ill in trying to get to the bottom of the financial meltdown.

We are in one of those “generational revolutions” that Jefferson said were as important as anything else to the proper functioning of our democracy. We can no longer pretend that our collective behavior as a nation for the past 25 years has been worthy of us as a people. Many of us hoped that Barack Obama’s election would redress the dire decline in our collective ethic. We are 139 days into his presidency, and while there is still plenty of hope that Mr. Obama will fulfill his mandate, his record on searching out the causes of the financial crisis has not been reassuring. He must do what is necessary to restore the American people’s — and the world’s — faith in American capitalism and in our nation. Answering our questions may help us get back on track. But time is wasting.

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