“Neither a borrower nor a lender be,” says Polonius to Laertes, “for loan oft loses both itself and friend, and borrowing dulls the edge of husbandry.” Shakespeare often finds wise words in fools and mocks rulers for their foolishness.

We see high drama played out again in Washington as the money-men ask for more, cloaked in concern for the real economy, while missing the option of direct stimulation by government where it is needed most. There are always duels for our attention. Will we deal with the long-term reality or do we deal only with the immediately apparent symptoms of tragedy? The likely compromise must deal with both, not just the money economy.

According to Secretary of Treasury Henry Paulson, banks are refusing to lend because they don’t trust their valuations of debt. His arguments are analogous to supply-siders considering the chaos in the credit markets. In short, he warned people with money (including banks and insurance companies) would fail to support the economy unless the government assumed their bad debts. Because they are better off after the bailout, rich individuals and institutions will invest in the economy again, presumably creating more jobs. To complete this circle he must think we can then use workers’ taxes to finance the bailout under discussion in Washington. Unfortunately, it might have to be financed by infusions from abroad, in effect exporting the debt through treasury bonds. T-bills will become derivatives. Does this sound familiar?

Repacked by the Democrats, Paulson’s plan has blown up because conservative House Republicans up for election, along with a super-majority of the general public, are rightly concerned. Whether the final version of Treasury’s effort to stabilize credit passes, there is probably going to be a recession anyway, and even the Paulson/Bernanke team could give no assurance their plan would guarantee success. The wrong move now may turn a likely recession into a depression. In the vernacular of my students this is known as “pulling a Hoover.”

The upstart Republicans are half right. But there may be a better way for populists in both parties.

We are at the end of the supply-side era. When you take a broad perspective on the Paulson/Bernanke plan for our salvation, it looks more and more like the same old trickle-down economics of the past. The theories of Arthur Laffer supported tax cuts for the rich in the hope their discretionary income would result in investments, new jobs, and compensating tax revenues from the new workers. These arguments along with the monetary theories of Milton Friedman and others have dominated thinking of so-called conservatives since the time of Reagan.

I read somewhere that Laffer himself has admitted he was wrong in the 80s. Tax reductions worked in the sixties under Kennedy, but the economy was then on an upswing anyway. We are on the other side of the curve now. After all the reassuring statements by Secretary Paulson about the economy since the real estate slump began, why should we believe him now or a President who has cried wolf so many times before?

The smoking gun making the point is Paulson’s conjecture companies might not accept the government bailout if Congress required an equity stake for taxpayers or reduced executive compensation. (I have no idea how they would explain their response to stockholders.)

Are the banks, in effect, holding the real economy hostage?

Saying assumption of this debt by taxpayers gets at the root of the problem is also disingenuous. Paulson means to say, "The root of the problem in the *money economy* is the virtualization of wealth." Mortgage bonds and derivatives are Wall Street innovations since former Senator Phil Graham had his way with deregulation if not before. The root problem in the *money economy* is mortgage paper. The root problem with mortgages is the price of real estate, or lack of jobs, features of the *real economy*. If you wanted to get to the root of the problem with equally band-aid logic, you should ask the Congress to take over all mortgages or provide a household bonus of $10,000 per family.

One of the many failures of Reaganomics was the assumption the wealthy would earmark sufficient amounts of their tax breaks for investments in the economy. The rich spent more, but not necessarily in productive investments, and not necessarily investments in our economy. Much more lucrative pickings were found abroad as our nation became poorer as a whole. We became poor enough to need subsidies from abroad. Under Reagan alone the U.S. shifted from being the largest creditor nation to the largest debtor to the world and the madness continued. We cut taxes while waging an unnecessary war which effectively eliminated Iran's nearest external threat!

We are now asked to borrow more to help out the money economy. Who will invest in our debt then? Won't there be a terrible run on the dollar? This will be good for exporters and investors with holdings in other countries but the cost of imports will go up along with interest rates. This is sure-fire inflation.

Critics of Reaganomics argued from the outset that direct stimulation of the economy by Congress would be better than assuming tax cuts for the rich would guarantee job creation. This suggests an option Congress is also considering today but will it be enough?

If Wall Street cannot evaluate the value of the instruments Paulson urges us to buy, how can the government do a better job? Toxic debt is by definition the supreme of the intangible. Paulson said the only other options are worse. It is very difficult for him to consider other options because he made his mark as an investment banker. At best he offers a near term solution to a long-term problem. He is working on treating the symptoms of the disease as perceived by a banker, rather than a cure. If he were a titan of production or technology innovator, he might be less biased in favor of a monetary cure and perhaps consider a fiscal one. Besides, even when dealing with the banks, other historical alternatives are possible with a simple change in the bankruptcy law as Professor Luigi Zingales points out in "Why Paulson is Wrong."[i] Furthermore, a substantial number of other economists agree the Paulson/Bernanke plan redux will not fix the main problem.[ii] They are already talking about trickle-up economics.

Alternatively, rather than bail out the rich with high hopes for the future, why not begin rebuilding the country by an immediate stimulation of $700,000,000,000, a number over a thousand times the speed of light in miles per hour. (Let's stop kidding ourselves by omitting the zeros.) What might be done with a direct investment in the real economy of the United States, rather than bailing out the "unreal " part of the money economy created by Wall Street in derivatives and other innovations? Why invest $700,000,000,000 in intangibles rather than tangibles? In economist-speak, "we must weigh the opportunity costs."

Remember the canard about Chinese symbols for the word crisis: "danger plus opportunity."

There are many alternative investments we might make for our tax dollars in energy, for example. We are weaker internationally since we use and import so much oil. We also have a climate problem that may already be irreversible given scientists' concern about methane being released in the Artic. We should not be diverted from addressing these challenges by a whimper from Wall Street, as Phil Gramm might say if he were consistent.

What if Congress gave every state a fair share of $700,000,000,000 to spend on energy infrastructure or research projects on energy conservation and non-polluting energy projects? Power lines to nowhere, except where the wind blows aplenty, for example. But what is a fair share? Allocation according to population distribution might be one way; a state's contribution to the economy might be another. Or, an equally weighted average of the two might satisfy critics, giving Alaska and Rhode Island more. Furthermore, the states might be encouraged to swap allocations, kind of a carbon credit dividend. This is, after all a global problem not a state issue.

There should be controls on what projects the states undertake. Since Congress is too vulnerable to lobbyists and earmarks, we could have the requests evaluated and ranked by the National Academy of Sciences on the basis of cost effectiveness and thermal efficiency (minimization of entropy increase). Congress could vote up or down on a package each year as it did with base closing. Also, an information clearinghouse should be established to show what each state and other countries are doing and thinking. There's nothing wrong in learning from others; we have a lot to learn from Japan and Germany.

Many other projects come to mind. But they must all deal with the real infrastructure of the economy. Energy is the basis of all things as physicists have known since $E=MC^2$.

Of course the financial markets may remain in turmoil. But as the money is spent, jobs will be created, and perhaps people will save more and the banks will be saved at last. In addition, we would have better transportation, less pollution, more energy independence forever—something tangible—less derivative. In exchange for these real investments, taxpayers would have something worth saving for, a much better buy than "mark to market" salvage of worthless paper created by bankers.

When trickle-down fails, trickle-up will follow anyway as it did after the collapse in 1929. Why not now? Congress is no J.P. Morgan but it can remember the teachings of Dr. Economy, Franklin D. Roosevelt. If we neglect the real economy future students will label our failure: "to pull a Bush."

We need to sharpen the edge of husbandry not dull it.

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[i] Joseph E. Stiglitz, editor, *The Economists' Voice,* online edition: http://www.bepress.com/ev/, September 26, 2008
[ii] Kevin G. Hall, "Is the bailout needed? Many economists say 'no,'" McClatchy Newspapers, September 25, 2008, http://www.mcclatchydc.com/227/story/53107.html.