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## 'Think Long' to Solve the Crisis

*It's the only way to sustain lasting benefits from the stimulus.*

By GEORGE P. SHULTZ

The current economic crisis must be viewed as a gigantic wake-up call. We have been living beyond our means for some years now, and the message is clear: We must change our ways. We are so blessed with human talent and resources that we can meet the challenges and succeed.

How did this crisis get started? The effort to identify the sources of the problem can easily lead us into staggering complexity, but the outline is simple. In the first place, the environment included a prolonged period of Fed-provided, exceptionally easy money.

People and institutions behave more responsibly when they have some of their own equity at stake, some "skin in the game." The current financial crisis emerged after this principle became virtually inoperative. In an effort to make housing more affordable, financial wizards, with the implicit backing of the federal government, figured out how to give houses away: no down payment and few if any questions asked about ability to service loans.

When you give something away, demand rises rapidly, as do prices, so rapidly rising prices made the easy terms look reasonable and seemed to validate them. Meanwhile, financial intermediaries packaged these mortgages and traded in them, in all too many cases with very high (30 or more-to-1) leverage. Once again, there was little equity in these deals.

All this separated the originator of the mortgage (that is, the risk) from the eventual holders and, at the same time, created financial instruments that were obscure. So people had little equity in the game but made lots of money even while not knowing exactly what they were doing. As Charles Prince, then head of Citicorp, said, "[A]s long as the music is playing, you've got to get up and dance." What a party!

And now we have the hangover: bailouts of many financial institutions by the taxpayers. The Fed and the Treasury already have exposures in the trillions of dollars.

These events are not isolated instances that sprung from the blue. Rather, they're the product of our failure to deal adequately with clear problems and to think ahead about future consequences. So now, think long.

Taken as a whole, our society has been living beyond its means for a long time now. The fact that we consume more than we produce is made possible by the ever-larger deficits in our trade balance with the rest of the world. We import more than we export. This negative balance of trade has its financial counterpart.

In recent times, we have failed to save enough to finance our own investments. This is true of Americans as individuals and families, but also of our biggest collective effort -- the federal government. Deficits, acts of dis-saving, have, with the exception of a few years, become chronic. When we support our activities by financing from abroad, we are selling to others a piece of our future. So, with all due recognition of the immediate need to encourage spending, let us not forget the long-term need for a return to a pattern of higher savings.

The fact is well known and well documented that Social Security will soon reach a point where the large inflow of money generated by the payroll tax is insufficient to cover promised benefits. This prospect presents a major budget problem. We know how to fix this problem in the long run without threat to the incomes of older people and without increasing the payroll tax. This can be done by using one of several possible changes in the method of indexing benefits and, eventually, indexing retirement age to account for greater longevity, with workers 55 or older and with workers at the low end of the income scale completely protected.

We know that the costs of our health-care system are spinning out of control, and we also know that a large amount of that money is wasted. We need a system that avoids those wastes, improves quality, keeps costs under control, and is universally available. There are paths to these goals. We also know that wage and price controls, with their important, adverse consequences in the long run, are not among them.

We know that the reason for our impressive health and longevity compared with earlier years is largely attributable to a breathtaking run of basic research and its application. In some cases progress is slow, and in others it is dramatic, as in the conquest of polio with the Salk vaccine. Funding for this basic research effort and for basic science generally is an investment in our future.

We have been on an energy roller-coaster for the last four decades or so. This time, more brilliant scientific minds than ever are at work, and more ideas with genuine applicability are appearing. Keep this effort going so that we can get on to a steady course of a more secure and less threatening energy future.

We are blessed with opportunities and with inventive and productive people. If we roll up our sleeves today, we will emerge stronger and with confidence in our future. A competent, sustained effort to deal effectively with long-term issues is essential to reap real benefits from any immediate stimulus to the economy.

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