HIGH & LOW FINANCE

Determining Who Rides the Lifeboat

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"I ask you, what am I? I'm one of the undeserving poor. That's what I am. Think of what that means to a man. It means that he's up agen middle class morality all the time ... I don't need less than a deserving man; I need more. I don't eat less hearty than him, and I drink a lot more."

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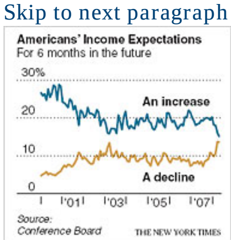

— Alfred Doolittle, in "Pygmalion" by George Bernard Shaw

"If investors choose to walk away because they put no money down and their free option is now worthless, we do not believe taxpayers should be held accountable. We are focused on helping homeowners who want to stay in their homes and have the financial wherewithal to do so."

— Robert K. Steel, under secretary of the Treasury for domestic finance

As the mortgage crisis spilled over into a credit squeeze that threatened to bring down Wall Street, the government has tried to find ways to prevent disaster while not helping those who do not deserve help.

That can be seen in the program the Federal Housing Administration initially offered to homeowners facing ballooning mortgage payments. It would refinance their mortgages, but only if they had proved they were deserving by keeping current on the payments before the interest rate reset.

It turns out, as Rachel L. Swarns reported in The New York Times this week, that there are not enough of them who need help. So the program has been expanded to allow refinancings for those who had missed no more than two payments — but only if there were extenuating circumstances, like lost jobs, pay cuts or illnesses.

We want to help homeowners in trouble, but only if they are deserving. Alfred Doolittle would not be surprised.

Mr. Steel, in a speech this week to the Society of American Business Editors and Writers in Baltimore, made clear that he did not want to bail out homeowners who are not deserving of help, a class that includes "investors" who put no money down.

In the same speech, he became the first Bush administration official, at least to my knowledge, to cite the late economist Hyman Minsky in explaining what has gone wrong. Minsky is more often quoted by liberals who want to justify more government regulation of a capitalist system that is prone to excess.

"Minsky," Mr. Steel said, "described how strong economic periods fueled optimism among lenders and borrowers. Eventually during a boom, however, what is initially rational enthusiasm turns excessive as both borrowing and lending become increasingly speculative. At some point during the later stages of the speculative boom, buyers become less eager to buy and sellers become more eager to sell. That, Minsky postulated, would develop into a period of financial distress. This framework certainly seems to capture the issues and challenges of today."

As it happens, Minsky is enjoying something of a revival. Two of his books, "John Maynard Keynes," and "Stabilizing an Unstable Economy" were just republished by McGraw-Hill, and his contention that stability is inherently unstable seems more relevant than ever in the aftermath of the period of low market volatility that ended in the current crisis.

In the latter of those books, published in 1986, Minsky wrote, "If the institutions responsible for the lender-of-last resort function stand aside and allow market forces to operate, then the decline in asset values relative to current output prices will be larger than with intervention; investment and debt financed consumption will fall by larger amounts; and the decline in income, employment and profits will be greater." In other words, without government bailouts, there can be a downward spiral.

The risk now is that letting market forces operate will create such a spiral. "The undeserving speculator who lied about his loan, put very little down, and now is increasingly indifferent to handing over the keys, is creating a growing stock of unsold homes that are producing an accelerating decline for house prices," said Robert Barbera, the chief economist of ITG.

"It invites a calculation that says, 'We are all a lot poorer, because our house values have fallen,' " he added. "That can become a self-reinforcing negative dynamic" that makes consumers fearful to spend and persuades them that buying a house is foolish until prices have fallen further.

That now seems to be happening. Over the six months through February, according to the Standard & Poor's/Case-Shiller home price indexes reported this week, home prices fell at an annual rate of more than 25 percent in Las Vegas, Phoenix, Los Angeles, San Francisco, San Diego and Miami.

The Conference Board consumer confidence survey found that only 15 percent of Americans expect their income to rise over the next six months, the lowest figure since the survey began in 1967. The proportion planning to buy a house is at a 33-year low. The proportion planning to take a vacation within six months has never been lower.

To reverse that dynamic, the government may eventually decide that it is necessary to bail out the undeserving as well as the deserving, no matter how repugnant that seems at the moment, and no matter how bad the inflationary impact may be.

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