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# The Phony Stimulus

**The Bush economic plan is a \$150 billion debacle. Here's a cheaper, more effective, and longer-lasting alternative.**

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- By [James J. Cramer](#)
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(Photo: Mauricio Lima/AFP/Getty Images)

Everybody likes "free" money. So it's no wonder that President Bush's plan to give up to \$1,200 per family to taxpayers to get the economy moving again will sail through Congress. The logic seems compelling: We face a looming recession because the consumer isn't spending. Give 'em some money to spend! The president's team is hailing the plan as a cheap \$150 billion shot in the arm that will check the downturn and get the economy rolling again.

Do you mind if I'm blunt and say that this is the stupidest, most wasteful, and least effective idea possible to reverse the decline in the U.S. economy, a decline that is pulling the rest of the world down with it? The only stimulus this package will generate is a

boost to the bottom lines of Men's Wearhouse or Nike or maybe Apple, as if what really ails America is slowing suit, sneaker, and iPod sales. The stimulus plan shows, once again, the cluelessness of this administration about how the economy works, something I find especially depressing given that Hank Paulson, the Treasury secretary who was no lightweight when he ran Goldman Sachs, should know better. He must know the plan will do nothing, other than get some politicians reelected, because it doesn't address the core issue: the decline of home prices in America and the broader financial impact of that decline. Until homes sell for \$1,200, this plan's not worth the paper the rebate checks will be printed on.

The fact is, we can attack the root of the crisis, mortgage-related problems, for far less money and resurrect the economy much faster with a couple of simple ideas. First, let's take a hard look at the real cause of the problem: We have too many defaulting mortgages and home-equity loans from people who bought homes-some on speculation, some because they actually wanted to live in them-and could not afford the purchase price. Encouraged by former Federal Reserve chairman Alan Greenspan and current chairman Ben Bernanke, home buyers used exotic mortgages that required them to put little money down to purchase homes that were quickly appreciating in value. Millions of home buyers then took home-equity loans on top of their mortgages to capitalize on that appreciation. Now that home values are declining nationwide and mortgage rates are being reset higher, the buyers can't afford to pay either their first mortgage or the home-equity loan and are facing defaults and foreclosures that threaten to leave them destitute.

It's tempting to suggest an Agricultural Adjustment Act type of program under which we actually obliterate excess homes that can't be sold. That would certainly restore home-price appreciation, but Toll

Brothers houses cost a whole lot more than pigs or corn, and even the winners in that game might find that solution excessive.

But there's another strategy that's by far the cheapest and most immediate way to deal with the problem: The Federal Reserve needs to cut the federal-funds rate, the short-term rate that it lowered last week to 3.5 percent, in half, to 1.75 percent, and it needs to do it now. That would be a huge shock treatment that would send mortgage rates plunging and allow home buyers from the 2005-2007 vintage, where the real problems are, to escape the death spiral of adjustable mortgage resets (those rates are pegged to the federal-funds rate). For those who have put down little or no equity and are hanging on, the Federal Housing Administration also needs to guarantee a refinanced mortgage at a much lower rate, which it will be able to do without much risk if the federal-funds rate is cut that low. The FHA is already set up to make just this kind of guarantee (and funded to absorb potential losses). Meanwhile, a huge number of people with good incomes and equity in their homes will be able to refinance their existing mortgages, which would put far more spending money in people's pockets than a onetime \$1,200 check. In fact, in many cases it could produce that kind of savings every month.

With short rates this low, people would also come off the sidelines to take advantage of the glut and buy homes. Some would say that the short-term teasers that would be available could cause the same problems we had in the last go-round. But the unscrupulous lenders who made those loans are almost all wiped out, so that's not an issue, and only creditworthy borrowers would be able to take advantage of the new loans, so there is no moral hazard there. Bankers have at last learned to give loans that actually have a chance of being paid back to their own banks instead of shipped off to Wall Street as part of a residential-mortgage bond that no one trusts or wants anymore.

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Finally, to ensure that mortgage money is available, banks have to be able to quantify their current losses on their –residential–mortgage bonds. Right now, most of the toxic instruments the banks hold that might go belly-up are insured by two large financial insurers, Ambac and MBIA. The losses on these pieces of paper are so much greater than those companies can absorb that the banks can't count on getting paid from them in the event of a default. The uncertainty is paralyzing the major banks. What the federal government should do is guarantee the insurance that has already been written, taking warrants in both companies, à la the successful Chrysler bailout of the eighties. If we are worried about the cost of those guarantees, we can limit it, allowing only a 50-cents-on-the-dollar payout on the insurance. With

this guarantee in place, banks would be free to make the loans they can't afford to make now and get the economy moving again. Given the low rates that they would have to pay to depositors (they're also keyed to the federal-funds rate), banks could lend at 5 percent, a good deal for borrowers, and still make terrific profits that could be used to offset the losses they would have to take on the portion of their bad loans that are not guaranteed.

What about inflation? We only need a temporary dip in rates, just long enough to refinance everyone, then we can take rates back up again. Frankly, the mortgage mess is so deflationary it wouldn't hurt to have a few months of inflation.

Why hasn't a plan like this been suggested before? We have a Fed that only recently woke up to the crisis and is so ridiculously independent despite its obvious incompetence that it can't be counted on to take rates to levels that would make my plan work. When this problem is fixed, and rates are then brought up higher once refinancing is in place, Congress should investigate why the Fed keeps getting it wrong and whether the power and independence of these unelected academics is a good thing, considering their endless recklessness. Meanwhile, you can spend \$150 billion making sure that the mall is jammed for a couple of Saturdays. Or you can spend virtually nothing by slashing rates and offering mortgage-insurance guarantees to banks and get the country moving within a matter of months. It's the free solution to a trillion-dollar problem that will never be cured by a bogus stimulus boondoggle.

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James J. Cramer is co-founder of [TheStreet.com](http://TheStreet.com). He often buys and sells securities that are the subject of his columns and articles, both before and after they are published, and the positions he takes may change at any time. At the time of this writing, he owned Goldman Sachs, Transocean, and Citigroup for his charitable trust. E-mail: [jjcletters@thestreet.com](mailto:jjcletters@thestreet.com). To discuss or read previous columns, go to James J. Cramer's page at [nymag.com/cramer](http://nymag.com/cramer). Get all of James J. Cramer's stock picks via e-mail, before he makes the trades, by subscribing to Action Alert Plus. A two-week trial subscription is available at [thestreet.com/aaplus](http://thestreet.com/aaplus).

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