What about austerity?

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Within the billions of sentences about the financial bailout there is one word notably absent, austerity. All talk is of payments, supports, subsidies, incurring more debt, stimulus packages. The thesis seems to be: If only we spend more the party can go on. True, only if the financial meltdown is a temporary mismatch and dislocation in housing and credit markets. But suppose there is something fundamentally wrong with the US economy. Then spending more will not fix it. Getting the diagnosis right means getting the treatment right. It may save us a trillion or two.

The subprime collapse is one symptom of years of little regulation, under-taxing, overspending, and massive debt. One way to understand what is happening in the United States is to look at what occurred time and again in Latin America and Asia, hotbeds of financial and banking crises. What we are living through happened time and again in Brazil, Argentina, and Mexico, as well as Korea and Thailand.

If there is too much debt, people lose confidence in the banks, then credit markets, currency, and government.

For more than a decade, the international financial cop, the International Monetary Fund, forecast a hurricane was heading toward US shores. As did many heads of the treasury and the Fed. It is, to paraphrase a great writer, a chronicle of an agony foretold. There are five basic drivers of these crises, all based on excess: high income concentration, too much debt, too much reliance on foreign money, not enough tax revenue, and reckless government spending. Time after time governments believe they are different. They are bombarded by warnings but ignore, postpone, spend even more, and crash.

Over past decades, most US wages have fared poorly. Despite stagnant wages, consumer spending and debt increased, fueled by cheap credit. Companies also went on a debt binge. Careless deregulation allowed financial cowboys to run the system. Responsible CEOs who kept some cash, maintained moderate debt, invested for the long term, got pink slips. Financial chop shops did leveraged buyouts using a company's own cash and credit. To survive, companies piled on debt.

Many politicians decided reelection depended on cutting taxes and offering more benefits. Increase Medicare, postpone Social Security reform, hire more bureaucrats, and pay for a two-front war. Debt grew to pay for this party. These were not true tax cuts, just postponed debt; now we owe more and the bill has come due with interest.

Complicating this crisis is US economic hegemony. There were few places to park a lot of money. Despite the euro, European policies on debts and deficits are not much to brag about. So foreigners have gorged on US debt. The United States continues importing more than it exports. Middle Easterners and Asians who save and invest bought dollars for decades, but some of this money is now fleeing. The dollar has dropped sharply. Gold and oil have skyrocketed. In financial crises, huge pools of capital cross borders very quickly; a few can make a great deal of money shorting the country's currency.

The United States requires a massive restructuring to address its debt, cutting back on its borrowing, spending, and wars. The bailout package is essential to keep the credit markets open. But absent sentences that include the word austerity all the bailout will accomplish is a temporary postponement. Bailout and stimulus are a stopgap.

A solution requires the country to begin to spend what it earns, reduce its mountainous debt, and address massive liabilities, restructure Social Security, pension deficits, military, and Medicare. No wonder politicians would rather spend more of your money now rather than address these problems. Because we have been spending 5 to 7 percent more each year than we earn, a forced restructuring, triggered by a currency collapse, would have the same effect on wages and purchasing power that the housing collapse had on housing prices. So let's learn from our Latin and Asian friends and act before it is too late.

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