JOE NOCERA
Talking Business

Wall Street 'has yet to learn'

And on the ninth day, the president jawboned. I hadn't heard that verb — "to jawbone" — in years, but it sprang to mind when I saw what President Barack Obama did Thursday.

Angered by the news that Wall Street was doling out $18.4 billion in bonuses for 2008 — "the sixth-largest haul on record," according to a front-page story in The New York Times, despite billions upon billions in losses — the president called reporters in, looked sternly into the cameras and unloaded on Wall Street executives, just as President John F. Kennedy once unloaded on America's steel barons.

"That is the height of irresponsibility," Obama said sharply, referring to the bonuses. "It is shameful." Wall Street, he said, was coming to the government for badly needed help — which taxpayers were providing, because otherwise "the entire system could come down on their heads" — and the government had a right to expect "some restraint, some discipline and some sense of responsibility" in return.

After going on in this vein for a while, he slapped Citigroup around for ordering a $50 million corporate jet "at the same time it was taking TARP money." The government's demand that the plane order be canceled should have been unnecessary, "because they should know better," he scolded.

Obama didn't take a shot at John Thain, the former chief executive of Merrill Lynch, fired this past week by his new boss, Ken Lewis at Bank of America, after Merrill reported a $15.3 billion loss in the fourth quarter. But then, he didn't have to. The revelation that Thain had spent $1.2 million remodeling his office — and then paid big bonuses to Merrill's troops as the firm's red ink was forcing Bank of America to seek more government help — has turned Thain into the new Richard Fuld, the former Lehman Brothers chief who [illegible] wife a mansion for almost nothing [illegible] now the person Americans would [illegible] to punch in the nose.

[illegible] past week, about 100,000 layoffs [illegible] announced at U.S. companies — 75,000 [illegible] alone. Everywhere in the United [illegible] people are feeling the pain of this recession. Even those with jobs [illegible] future. Their retirement savings [illegible] been decimated. They are [illegible] angry.

[illegible] by Wall Street should not be [illegible] oversized bonuses and $50 [illegible] generate outrage — and [illegible] from the president. "It [illegible] selfishness of people on Wall [illegible]" Charles Elson, a corporate governance expert at the University of Delaware, who sounded pretty outraged himself. "Wall Street has yet to learn the lesson of what happened."

What happened, put simply, is that the people who thought of themselves as the smartest guys in the room — and were paid accordingly — weren't so smart [illegible] brought down the financial [illegible] building they got from the [illegible] that they are going to be [illegible] a good long time.

[illegible] right down to it, no company [illegible] group or Bank of America is [illegible] — or even be mildly dented [illegible] a new corporate airplane [illegible] fancy office. Lots of [illegible] $1 million or more in [illegible] expenses when they get the [illegible]'s pocket change. And you can [illegible] halfway-decent business case [illegible] airplane. (It goes farther than [illegible] take more executives to [illegible] the top brass to be more [illegible] productive, etc., etc.) And [illegible] The New York Post, which [illegible] plane story, asserted, it is [illegible] that these things were paid [illegible] bailout money, which is [illegible] as capital to shore up [illegible]

[illegible] You could make the same [illegible] the auto executives who flew [illegible] corporate jets to ask [illegible] assistance. Surely it was a better [illegible] to fly than to drive from [illegible] the second time around, [illegible] for taking the jets. That [illegible] What matters is the [illegible] time when the country is in [illegible] executives are asking for [illegible] that smacks of plutocracy [illegible] justifiable populist anger [illegible] building for 20 years," said [illegible], the director of corporate [illegible] the American Federation of [illegible] and Municipal Employees [illegible] people haven't gotten [illegible] economy. They understand that [illegible] wealth has been created, and [illegible] mine?"

[illegible], "These guys seem to be [illegible] universe. So the symbolism [illegible] stand and the private jet is [illegible] umbrella stand, of course, was [illegible] the $15,000 umbrella stand that [illegible] chief executive, L. Dennis [illegible] bought with company funds — [illegible] the reason Kozlowski is now [illegible]

[illegible] is something else as well. Most [illegible] fully understand what, exactly,

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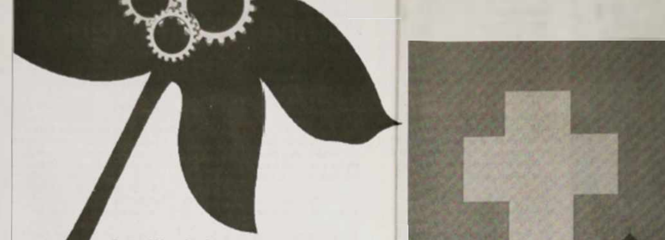
Making the most of a recovery



Officials have rare chance to reshape a U.S. economy whose flaws have been laid bare

By David Leonhardt

The U.S. economy will recover. It won't recover any time soon. It is likely to get significantly worse over the course of 2009, no matter what President Barack Obama and Congress do. And resolving the financial crisis will require both aggressiveness and creativity. In fact, the main lesson from other crises of the past century is that governments tend to err on the side of too much caution — of taking the punch bowl away before the party has truly started up again.

"The mistake the United States made during the Depression and the Japanese made during the '90s was too much start-stop in their policies," Timothy Geithner said when I went to visit him in his transition office a few weeks ago, before he became the U.S. Treasury secretary. Japan announced stimulus measures even as it was cutting other government spending. Franklin D. Roosevelt flirted with fiscal discipline midway through the New Deal, and the United States slipped back into decline.

Geithner arguably made a similar miscalculation himself last year as a top Federal Reserve official who was part of a team that allowed Lehman Brothers to fail. But he insisted that the Obama administration had learned history's lesson.

"We're just not going to make that mistake," Geithner said. "We're not going to do that. We'll keep at it until it's done, whatever it takes."

Once governments finally decide to use the enormous resources at their disposal, they have typically been able to shock an economy back to life. They can put to work the people, money and equipment sitting idle, until the private sector is willing to start using them again.

But while Washington has been preoccupied with stimulus and bailouts, another, equally important issue has received far less attention — and the resolution of it is far more uncertain. What will happen once the paddles have been applied and the economy's heart starts beating again? How should the American economy be remade? Above all, how fast will it grow?

That last question may sound abstract, even technical, compared with the current crisis. Yet the consequences of a country's growth rate are not abstract at all. Slow growth makes almost all problems worse. Fast growth helps solve them. As Paul Romer, an economist at Stanford University, has said, the choices that determine a country's growth rate "dwarf all other economic-policy concerns."

FROM The New York Times Magazine

Growth is the only way for a government to pay off its debts in a relatively quick and painless fashion, allowing tax revenue to increase without having to raise tax rates. That is essentially what happened in the years after World War II. When the war ended, the U.S. government's debt equaled 120 percent of the gross domestic product (more than twice as high as its likely level by the end of next year). The rapid economic growth of the 1950s and 1960s — more than 4 percent a year, compared with 2.5 percent in this decade — quickly whittled that debt away. Over the next 25 years, if growth could be lifted by just one-tenth of a percentage point a year, the extra tax revenue would completely pay for an $800 billion stimulus package.

Yet there are real concerns that the U.S. economy will not grow enough to pay off its debts easily and ensure rising living standards, as happened in the postwar decades, because two of the economy's most powerful recent engines have been exposed as a mirage: the explosion in consumer debt and spending, which lifted short-term growth at the expense of future growth, and the great Wall Street boom, which depended partly on activities that had very little real value.

Richard Freeman, a Harvard economist, argues that the U.S. bubble economy had something in common with the old Soviet economy. The Soviet Union's growth was artificially raised by huge industrial output that ended up having little use. America's was artificially raised by mortgage-backed securities, collateralized debt obligations and even the occasional Ponzi scheme.

Where will new, real sources of growth come from? Not from Wall Street, probably. Nor, obviously, from Detroit. Nor from Silicon Valley, at least not by itself. Well before the housing bubble burst, the big productivity gains brought about by the 1990s technology boom seemed to be petering out. Annual economic growth in the current decade, even excluding the dismal contributions that 2008 and 2009 will make to the average, has been the slowest of any decade since the 1930s.

So for the first time in more than 70 years, the epicenter of the U.S. economy can be placed in Washington. And Washington won't merely be given the task of pulling the economy out of the immediate crisis. It will also have to figure out how to put it on a more sustainable path — to help it achieve fast, broadly shared growth and do so without the benefit of a bubble. Obama said as much in his inauguration speech when he pledged to overhaul Washington's approach to education, health care, science and infrastructure, all in an effort to "lay a new foundation for growth."

For centuries, people have worried that economic growth had limits — that the only way for one group to prosper was at the expense of another. The pessimists, from Malthus and the Luddites and on, have been proved wrong again and again. Growth is not finite. But it is also not inevitable. It requires a strategy.

The upside of a downturn

Two weeks after the election, Rahm Emanuel, Obama's chief of staff, appeared before an audience of business executives and laid out an idea that Lawrence Summers,

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Profit slips at Exxon on slump in price of oil

By Jad Mouawad

NEW YORK: Exxon Mobil, the largest publicly traded oil company in the world, said Friday that its profit fell 33 percent in the fourth quarter of 2008 as the price of oil declined.

But in a year where oil rose to a record price before having its steepest-ever collapse, Exxon still managed to set a record as the most-profitable U.S. corporation. It earned $45.2 billion in 2008, up from $40.6 billion in 2007.

After riding a tide of swelling earnings in recent years, the once highflying oil sector is beginning to scramble to adjust to a sharp downturn. Oil prices have dropped more than 70 percent since peaking at $147.27 a barrel in July. After averaging $100 a barrel in 2008, oil prices this year are set to decline for the first time since 2001.

Because of its close attention to cost reduction and efficiency, Exxon is weathering the drop in oil prices better than most of its rivals. This past week, both Royal Dutch Shell and ConocoPhillips reported large quarterly losses as asset values dropped because of the fall in oil prices. Chevron on Friday posted a small rise in profit.

In the fourth quarter, Exxon said it earned $7.8 billion, less than expected by analysts and in contrast to $11.66 billion a year earlier. That was Exxon's weakest quarterly performance since the second quarter of 2005, and the first time since 2001 that its performance in the period, typically its strongest quarter, has declined.

"Weaker crude oil prices, higher operating expenses, lower chemical volumes and the impact of the Gulf Coast hurricanes were partly offset by higher downstream margins," it said. Exxon said that repairs and lower production because of Hurricanes Gustav and Ike lowered earnings by $570 million.

Exxon said that it gave back $40.1 billion to its shareholders in 2008, up 12 percent from 2007, as either dividends or share buybacks. Its spending on exploration, the heart of its business, rose 25 percent, to $26.1 billion, last year.

Exxon pumped about 2.47 million barrels a day of oil in the fourth quarter and produced 9.8 billion cubic feet, or 278 million cubic meters, of natural gas a day. Over all, oil and gas production decreased 3 percent in the fourth-quarter from a year earlier. In some countries, Exxon is entitled to fewer barrels of oil when prices rise.

Chevron said Friday that its net income rose 1 percent, to $4.9 billion, in the quarter. For the year, the company's earnings rose 28 percent, to $24 billion.

Faced with the sharpest downturn in 25 years, most oil companies are trimming investments and cutting costs. In recent months, projects have been canceled or deferred in Australia, Canada and Saudi Arabia.

In some cases, companies are waiting for costs to fall. In others, they are deferring expensive projects that have become unprofitable at today's lower oil prices. The collapse of the financial sector has made it much harder, and far more expensive, for companies to finance multibillion-dollar projects. In many cases, financing has simply dried up. Energy executives have warned in recent days that oil prices have fallen too fast, and too low, to pay for new and more expensive projects.

Tony Hayward, the chief executive of BP, said Thursday at the World Economic Forum, in Davos, Switzerland, that prices of $60 to $80 a barrel were "appropriate" to sustain investments, especially for producers from the Organization of Petroleum Exporting Countries.

Oil was trading Friday afternoon at $41.75 a barrel in New York. Many experts have warned that there could be a sharp rise in prices when consumption eventually picks up. Fatih Birol, the chief economist at the International Energy Agency, estimates that around $100 billion in projects, mostly outside of OPEC, have been delayed or canceled over the past year because of weaker oil prices.

The Exxon chief executive, Rex Tillerson, has signaled that the company may actually increase its investments by 20 percent this year. It is sitting on nearly $40 billion in cash that could provide it with a strategic war chest to make acquisitions, according to analysts.

Tough talk on bankers' bonuses probably too late to matter

By Eric Dash and Vikas Bajaj

NEW YORK: "Shameful." "Outrageous." "The height of irresponsibility."

President Barack Obama had some harsh words Thursday for bankers who paid themselves billions of dollars in bonuses despite the sweeping government rescue of the financial industry.

Senator Christopher Dodd, Democrat of Connecticut, said, "Every possible legal means" should be used to claw the money back.

But the sober reality, compensation experts say, is that most, if not all, of the money that banks have paid out is probably gone for good. The "legal means" Dodd referred to are few. Unless actual wrongdoing is uncovered at the banks — and so far prosecutors have not disclosed any — the case for clawing back past pay is weak.

"It's not as easy as pounding the gavel on the table," said Michael Melbinger, an executive compensation lawyer at Winston & Strawn in Chicago.

How bonuses are paid in the future is another matter, of course.

The furor is putting pressure on banks to change the way they pay their employees, particularly when that pay turns out to be based on phantom profits, as was often the case in recent years.

Calls for changes are growing, and the salvos from Washington may have been partly intended to shame Wall Street into action.

The political storm was unleashed during the past week by a report that found financial executives in New York had received an estimated $18.4 billion in bonuses for 2008, less than for the previous several years but the same level as they had received in 2004, when times were flush. While many top executives went without bonuses, the average payout was $112,000.

"There will be time for them to make profits, and there will be time for them to get bonuses," Obama said during an appearance in the Oval Office with Treasury Secretary Timothy Geithner. "Now's not that time. And that's a message that I intend to send directly to them — I expect Secretary Geithner to send to them."

The banks are feeling pressure to change the way they pay employees.

It was a pointed — if calculated — flash of anger from the president, who frequently railed against excesses in executive compensation on the campaign trail. He struck his populist tone as he confronted the possibility of having to ask Congress for additional large sums of money, beyond the $700 billion already authorized, to prop up the financial system, even as he pushed Congress to move quickly on a separate economic stimulus package that could cost American taxpayers $900 billion.

In the past week alone, U.S. companies reported tens of thousands of job cuts, and public anger is rising over reports of profligate spending by banks and investment firms that are receiving help through the $700 billion bailout fund. About half of that $700 billion is still available, but the new administration has yet to announce how it will use it, and many analysts say it will take far more money to stabilize the banking system.

Should Obama have to go to Congress to seek more money for the bailout fund to avert the failure of more banks, he would probably encounter opposition in both parties and demands for tighter restrictions on pay for executives of institutions that received government assistance.

Geithner has already signaled a willingness to impose stricter compensation limits as part of a revamped approach to dealing with the banking crisis.

With his strong words Thursday, however, Obama seemed intent on reassuring Congress and the public that he would step up the pressure on bankers before granting them additional assistance.

"That is the height of irresponsibility," Obama said angrily. "It is shameful, and part of what we're going to need is for the folks on Wall Street who are asking for help to show some restraint and show some discipline and show some sense of responsibility."

But companies have few legal options for recovering employees' pay, unless those employees have been involved in fraud or other wrongdoing. State wage laws and compensation contracts typically prohibit such attempts.

While several companies have recouped bonuses from executives and employees in recent years, those battles have been long and hard.

Regulators and shareholders recovered money from William McGuire, former chairman and chief executive of the UnitedHealth Group, after he was accused of backdating his stock options.

But U.S. regulators spent years trying to get Franklin Raines, former chief executive at Fannie Mae, to return his bonuses after accounting problems surfaced there and got only part of the money back.

New York State has a so-called fraudulent conveyance law that enables creditors to sue to recover unjustified compensation in certain cases. But to win, plaintiffs must show that the executives did not earn their bonuses and that the companies making the payments were undercapitalized.

The New York State attorney general, Andrew Cuomo, threatened to bring such a suit on behalf of the state against American International Group, the insurance giant, to compel

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WEEKEND BUSINESS

Mohamed El-Erian, chief executive of Pimco, the world's largest bond fund manager, foresees a loss in the bargaining power of workers before economic stabilization.

SPOTLIGHT

Peering into the fog

Investor expects closer regulation

By Karina Robinson

As chief executive and co-chief investment officer of Pimco, the world's largest bond fund manager, Mohamed El-Erian has strong opinions on the remaking of financial markets. El-Erian joined Pimco in 1999 after 15 years at the International Monetary Fund. He left Pimco in 2006 to become president of Harvard Management, which oversees Harvard University's endowment, and returned to Pimco in 2008. He is a member of the U.S. Treasury Borrowing Advisory Committee and chairman of Microsoft's investment advisory committee. On the eve of the 2009 meeting of the World Economic Forum in Davos, Switzerland, of which he has been a regular attendee, El-Erian spoke by telephone from his office in Newport Beach, California. Following are excerpts from the interview:

The conventional wisdom is that the world may escape deflation because of the vast sums of money being spent by governments, but that inflation is due to take off in a major way by 2010. What is your view?

I think if you look at a three-year period, that is exactly what is likely to occur. The journey is going to be a "V." We will continue to see price declines in the first half of 2009 as commodity prices fall and there is a loss of the bargaining power of workers. Then stabilization, then inflation is inevitable, as governments will overdo it when it comes to stimulus. The normal transmission systems are broken and governments will have to flood the market.

What is your view of a single regulator for financial services in the European Union and another single one in the United States, rather than a host of different ones that exist today?

I think that consolidating regulation is a first step. The U.S. suffers from fragmentation. It would make sense to move to one powerful regulator, provided it can be held accountable. The EU is more tricky. It would be difficult to have a single regulator that didn't have a big budget and the ability to impose laws. More harmonization is more likely.

The Group of 20 seems to want the IMF to be in charge of regulation on a global basis. But it has no expertise in this field. What is your view?

That is an example of the vacuum we have at the multilateral level.

The IMF stands out as the most capable to do so in relative terms. It has a history of being able to adapt. Against that, there are legitimacy issues in terms of representation and governance. It is not viewed as a trusted adviser and it does not have the resources. The success of this proposal would require major retooling. It needs to be representative of the world of today, not yesterday. It needs better access to the countries at the center of the system, particularly the United States. The crisis is at the center, not at the periphery. It is a crisis not in the system but of the system.

U.S. Treasury bonds are at new highs as investors seek havens. Are they the next bubble investment?

They are overvalued because of a flight to quality and liquidity. Over the next couple of years, there will be massive issuance, which will be the main driver of price.

What are the structural changes taking place in the global economy, and how will they play out?

First, there is an amazing lack of clarity. Governments are going from being referees in the market to also being players. It is not clear how this plays out. Secondly, there is a complete change in the financial landscape. The banking system will be slimmed down. Society cannot accept the privatization of gains and the socialization of losses.

The lack of clarity means that policy makers have to be very responsive and investors have to realize they can't do what they did in the past. Individuals and companies are suffering massive losses. The multilateral system will change. How it is all sorted out will impact my daughter's generation.

ON THE RECORD

"The artist's paycheck is every bit as important as the steel worker's paycheck or the auto worker's paycheck."

Robert Lynch, [illegible] of Americans for the Arts, asserting that arts jobs should figure in economic stimulus plans.

"This is not a company that needs to be pulled apart and left for the chickens."

Carol Bartz, chief executive of Yahoo

Reuters

"I want options that will hold up in a failing economy."

Dan Genovera, [illegible]

"It's like a guillotine."

Klaus Schwab, [illegible] World Economic Forum, on what [illegible] and politicians who lose their [illegible] happen to them [illegible]

What kind of recovery does U.S. want?

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Obama's top economic adviser, later described to me as Rahm's Doctrine. "You never want a serious crisis to go to waste," Emanuel said. "What I mean by that is that it's an opportunity to do things you could not do before."

In part, the idea is standard political maneuvering. Obama had an ambitious agenda — on health care, energy and taxes — before the economy took a turn for the worse in the autumn, and he has an interest in connecting the financial crisis to his pre-existing plans. "Things we had postponed for too long, that were long term, are now immediate and must be dealt with," Emanuel said in November.

Of course, the existence of the crisis does not require the Obama administration to deal with education or health care. But the fact that the economy appears to be mired in its worst recession in a generation may well allow the administration to confront problems that have festered for years.

The counter-argument is hardly trivial — namely, that the financial crisis is so serious that the administration should not distract itself with other matters. That is a risk, as is the additional piling on of debt for investments that might not bear fruit for a long while. But Obama may not have the luxury of trying to deal with the problems separately. This crisis may be his one chance to begin transforming the economy and avoid future crises.

In the early 1980s, an economist named Mancur Olson developed a theory that could fairly be called the academic version of Rahm's Doctrine. Olson, a University of Maryland professor who died in 1998, is one of those academics little known to the public but famous among his peers. His seminal work, "The Rise and Decline of Nations," published in 1982, helped explain how stable, affluent societies tend to get in trouble. The book turns out to be a surprisingly useful guide to the current crisis.

In Olson's telling, successful countries give rise to interest groups that accumulate more and more influence over time. Eventually, the groups become powerful enough to win government favors, in the form of new laws or friendly regulators. These favors allow the groups to benefit at the expense of everyone else; they not only end up with a larger piece of the economy's pie but also do so in a way that keeps the pie from growing as much as it otherwise would. Trade barriers and tariffs are the classic example. They help the domestic manufacturer of a product at the expense of millions of consumers, who must pay high prices and choose from a limited selection of goods.

Olson's book was short but sprawling, touching on everything from the Great Depression to the caste system in India. His primary case study was Britain in the decades after World War II. As an economic and military giant for more than two centuries, it had accumulated one of history's great collections of interest groups — miners, financial traders and farmers, among others. These interest groups had so shackled Britain's economy by the 1970s that its high unemployment and slow growth came to be known as "British disease."

Germany and Japan, on the other hand, had to rebuild their economies and political systems after the war. Their interest groups were wiped away by the defeat. "In a crisis, there is an opportunity to rearrange things, because the status quo is blown up," Frank Levy, an economist at the Massachusetts Institute of Technology and an Olson admirer, told me recently. Olson's insight was that the defeated countries of World War II didn't rise despite crisis. They rose because of it.

The parallels to the modern day United States, though not exact, are plain enough. America's long period of economic pre-eminence has produced a set of interest groups that, in Olson's words, "reduce efficiency and aggregate income." Home builders and real estate agents pushed for housing subsidies, which made many of them rich but made the real estate bubble possible. Doctors, drug makers and other medical companies persuaded the U.S. government to pay for expensive treatments that had scant evidence of being effective. Those treatments are the primary reason the United States spends so much more than any other country on medicine. In these cases, and in others, interest groups successfully pressed for actions that benefited them and hurt the larger economy.

Surely no interest group fits Olson's thesis as well as Wall Street. It used an enormous amount of leverage — debt — to grow to unprecedented size.

In good times — or good-enough times — the political will to beat back such policies doesn't exist. Their costs are too diffuse, and their benefits too concentrated. A crisis changes the dynamic. It's an opportunity to do things you could not do before.

Britain's crisis was the Winter of Discontent, in 1978-79, when strikes paralyzed the country and many public services shut down. The resulting furor helped elect Margaret Thatcher as prime minister and allowed her to sweep away some of the old economic order. Her laissez-faire reforms were flawed in some important ways — taken to an extreme, they helped create the current financial crisis — and they were not the only reason for England's turnaround. But they made a difference. In the 30 years since her election, Britain has grown faster than Germany or Japan.

The investment gap

One good way to understand the current growth slowdown is to think of the debt-fueled consumer-spending spree of the past 20 years as a symbol of an even larger problem. The United States has been spending too much on the present and not enough on the future. Americans have been consuming rather than investing. They are suffering from investment-deficit disorder.

You can find examples of this disorder in just about any realm of American life. Walk into a doctor's office and you will be asked to fill out a long form with the most basic kinds of information that you have provided dozens of times before. Walk into a doctor's office in many other developed countries and that information — as well as your medical history — will be stored in computers. These electronic records not only reduce hassle; they also reduce medical errors. Yet Americans cannot avail themselves of this innovation even though the United States spends far more on health care, per person, than any other country. Americans are spending their money to consume medical treatments, many of which have only marginal health benefits, rather than to invest it in ways that would eventually have far broader benefits.

Along similar lines, Americans are indefatigable buyers of consumer electronics, yet a smaller share of households in the United States has broadband Internet service than in Canada, Japan, Britain, South Korea and about a dozen other countries. Then there is education: America once led the world in educational attainment by a wide margin. It no longer does. And transportation: A trip from Boston to Washington, on the fastest train in the country, takes six and a half hours. A trip from Paris to Marseille, roughly the same distance, takes three hours — a result of the French government's commitment to infrastructure.

Tucked away in the many statistical tables at the Commerce Department are numbers on how much the U.S. government and the private sector spend on investment and research — on highways, software, medical research and other things likely to yield future benefits. Spending by the private sector has not changed much over time. It was equal to 17 percent of GDP 50 years ago, and it is about 17 percent now. But spending by the government — federal, state and local — has changed. It has dropped from about 7 percent of GDP in the 1950s to about 4 percent now.

Governments have a unique role to play in making investments for two main reasons. Some activities, like mass transportation and pollution reduction, have social benefits but not necessarily financial ones, and the private sector simply won't undertake them. And while many other kinds of investments do bring big financial returns, only a fraction of the returns go to the original investor. This makes the private sector reluctant to jump in. As a result, economists say, the private sector tends to spend less on research and investment than is economically ideal.

Historically, the government has stepped into the void. In the 1950s and 1960s, the GI Bill created a generation of college graduates, while the interstate System of highways made the entire economy more productive. Later, the Defense Department developed the Internet, which spawned AOL, Google and the rest.

The late 1990s Internet boom was the only sustained period in the last 35 years when the economy grew at 4 percent a year. It was also the only time in the past 35 years when the incomes of the poor and the middle class rose at a healthy pace. Growth doesn't ensure rising living standards for everyone, but it sure helps.

Even so, the idea that the government should be playing a much larger role in promoting economic growth would have sounded radical, even among Democrats, until just a few months ago. After all, the European countries that have tried guiding huge swaths of their economies — that have kept their arms around the "commanding heights," in Lenin's enduring phrase — have grown even more slowly than the United States in recent years.

But the credit crunch and the deepening recession have changed the discussion. The U.S. government now seems as if it was doing too little to take advantage of the U.S. economy's enormous assets: its size, its openness and its mobile, risk-taking work force. The government is also one of the few large entities today able to borrow at a low interest rate. It alone can raise the capital that could transform the economy in the kind of fundamental ways that Olson described.

"This recession is a critical economic problem — it is a crisis," Summers told me recently. "But a moment when there are millions of people who are unemployed, when the federal government can borrow money over the long term at under 3 percent and when we face long-run fiscal problems is also a moment of great opportunity to make investments in the future of the country that have lagged for a long time."

He then told a story that John F. Kennedy liked to tell, about an early-20th-century French marshal named Hubert Lyautey. "The guy says to his gardener, 'Could you plant a tree?'" Summers said. "The gardener says, 'Come on, it's going to take 50 years before you see anything out of that tree.' The guy says, 'It's going to take 50 years? Really? Then plant it this morning.'"

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Read the rest of this article and more of David Leonhardt's columns.

Pool photo by Ron Sachs

President Barack Obama unloaded on Wall Street executives this week, saying they should have shown "some restraint, some discipline and some sense of responsibility."

Wall St. 'has yet to learn' a lesson in restraint

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Wall Street did that caused so much trouble for the country and the financial system.

I spoke in the past week with David Smick, the author of a scathing book about Wall Street, "The World Is Curved: Hidden Dangers to the Global Economy." In indignant tones, he talked to me about the sophisticated off-balance-sheet vehicles the banks used to hide risk and game the system, and the "mortgage-backed securities they were shoving out the door."

He concluded, "I find their behavior just appalling."

But words like off-balance-sheet vehicles and mortgage-backed securities don't have much meaning for most of us. What we understand is greed — which, ultimately, is what Smick was talking about as well. For most Americans, big bonuses and corporate jets and office remodelings become a kind of stand-in for the real sins of the bankers. They signify what people hate about Wall Street.

The truth is, this is probably the last year for a good long while that Wall Street bonuses are going to be so out of whack. Partly that is because the U.S. government simply isn't going to let it happen again, at least not at any institution that has taken TARP money. The top executives at those institutions are required by law to get most of their bonuses in stock which they can't unload until the government is no longer a shareholder in the bank. Partly it is because, after the bonus fiasco this year, Wall Street finally understands that the public scrutiny is going to be fierce. The Wall Street argument that bonuses are really a part of overall compensation — well, that's just not going to fly in this environment.

But it is also because the business model of the investment banks is almost certainly going to change.

Over the past 20 years, investment banking went from being primarily an advisory business to being primarily a business in which firms traded for their own accounts — so-called proprietary trading. It is the trading business that made the banks so immensely profitable. It is also what propelled the creation of mortgage-backed securities and credit default swaps and all the rest of it. Those vehicles generated both enormous fees and enormous profits.

But that game is over. "It will be impossible to rebuild that business model, which relied so heavily on leverage," said William Hambrecht, the founder and chief executive of the investment firm WR Hambrecht & Co. "I don't think the government is going to let them take that kind of leverage again."

And the government will also tightly regulate complex securities. "So we are faced with an era of sharply reduced profit opportunities, which means a lot less income," Hambrecht added. To him, the big bonuses this year signaled that "Wall Street hasn't been able to admit that yet."

Ira Kay, a top executive consultant with Wyatt Watson, told me that this bonus season had been akin to "war" inside many Wall Street firms. "It is a small group of people who caused the problems," he said. But other bankers had very good years — and they didn't feel their bonuses should suffer because someone else lost billions. The fact that the government had to bail out the firm, that the rest of the country is suffering, that their world is changing — none of that mattered. They just wanted theirs.

That's what has to change.

And not only on Wall Street. I've long thought that the reason executive compensation has become such a flash point was that it, too, signaled an "I-want-mine" mentality among chief executives. It was infuriating to see them take down tens of millions of dollars, even as their company's stock fell and they laid off employees.

Next month, proxy season will begin, and we will start to see how much not just Wall Street chieftains made in 2008, but all executives who run public companies.

I asked Kay what we should expect. Did corporate executives understand the need to show that they are willing to sacrifice in these hard times, just like the rest of us? Or will we see them still grasping for every last dime?

"I am a little disappointed with the reaction of some of the executives," he replied. "The emphasis on pay-for-performance has gone up to an extent, but the executives are definitely not where their boards are, where the shareholders are, where the media is or where the government is. They are lagging on this."

I'm guessing that President Obama is going to be jawboning again before too long.

Tough tal[illegible] on bonuse[illegible] is probab[illegible] too late

BONUS, From Page 11

it to recover bonuses tha[illegible] paid and to suspend furthe[illegible] The company agreed to coo[illegible] Cuomo's office and suspe[illegible] bonuses, but it has not [illegible] previous payments.

The law may be mu[illegible] in recouping bonuse[illegible] banks like Merrill Lyn[illegible] America, because the[illegible] sidered undercapitaliz[illegible]

With AIG, Cuomo c[illegible] strong case that the [illegible] have enough capital. [illegible] the Federal Reserve [illegible] $85 billion to keep [illegible] would be harder to m[illegible] the banks, since they r[illegible] ital from the U.S. gove[illegible] earlier.

Other possible op[illegible] problematic.

Cuomo, other offici[illegible] holders could try to ma[illegible] banks committed secu[illegible] paying the bonuses.

In that case, they [illegible] prove that executives h[illegible]

Obama angril[illegible] bonuses paid [illegible] bankers as 'th[illegible] irresponsi[illegible]

rectors or withheld m[illegible] tion about the health o[illegible] be paid. Cuomo's [illegible] poenaed Merrill Lync[illegible] gating the timing an[illegible] big fourth-quarter los[illegible] bonus payout.

Recovering money [illegible] file bankers would be[illegible]

After all, there is [illegible] making bad decisi[illegible] those decisions lea[illegible] losses.

Legal experts say [illegible] states have wage pa[illegible] will not allow emplo[illegible] bonuses after they ar[illegible] have a legal claim to [illegible]

Even if Congress te[illegible] demand that Wall S[illegible] cancel their bonuses, [illegible] such action might put [illegible] violation of legally bin[illegible] tion plans.

While bankers ear[illegible] people in many othe[illegible] perts also noted that [illegible] for a large portion of [illegible] tion on Wall Street. W[illegible] try, many see bonuses [illegible] ferred salary, rather t[illegible] rewards for good perf[illegible] some bank employees [illegible] their jobs well, even th[illegible] ployers lost billions.

Despite the public o[illegible] compensation experts sa[illegible] missed a chance to impose [illegible] on 2008 bonuses last autum[illegible] government embarked on [illegible] plan.

"The time to say 'no bo[illegible] come and gone," said Bria[illegible] executive compensation c[illegible] "The horse is out of the barn [illegible] the horizon."

Sheryl Gay Stolberg, Stephe[illegible] [illegible] John Harwood contri[illegible] porting.