

not work their magic were it not for surplus capital looking for investment opportunities. Unless we redirect that capital, we will never be able to rein in the fantasy-finance casino.

So what can we possibly do when faced with such vast uncertainties? For starters, we can take a page from the financial sector: We can hedge. We should develop a rock-solid insurance policy to protect us from fantasy finance and its propensity to create financial crises.

Extraordinary times call for extraordinary measures. The bankers and industrial giants have figured out bold survival strategies for themselves. Raid the vault! We should do the same. To be sure, the public coffers also should be opened to fund robust public investments. *But instead of just raiding only our own treasury, we should raid the fantasy-finance vault.* We need a piece of the casino's action, starting now.

Financial Disaster Insurance

We need protection from the big boys. We need a collective insurance policy against meltdown. Therefore, we, the taxpayers as represented by our government, should collect insurance premiums from every nook and cranny of the financial sector, beginning immediately. The premiums would pay us back both for the current raid on the treasury and for the recession created by fantasy finance. The premiums also would help indemnify us for the next financial tsunami. Unless we entirely eliminate private financial markets, we can expect a never-ending chain of booms and busts. Yes, we should mitigate them through wise regulations and consumer protections. But no one can assure us that we'll never see another bust. Therefore we should demand insurance premiums against the probability of future financial meltdowns—collective protection against the worst-case scenario. We need our own credit default swap on the entire financial sector. The best way into the casino vault is to hit up all financial

transactions. How much casino action are we talking about? According to historian Niall Ferguson, "Every day two trillion dollars change hands on foreign exchange markets. Every month seven trillion dollars change hands on global stock markets." He also calculates there are about \$3 trillion in CDOs out there and that the estimated value of credit default swaps "was just under \$600 trillion."⁴ By my back-of-the-envelope calculations, I estimate that the global casino sees about \$900 trillion worth of transactions each year, plus or minus a few hundred trillion. If we collected a 3-basis point insurance premium (three one-hundredths of 1 percent or less than 1/3 of a penny per dollar) on the face value of each and every transaction, we could collect about \$2.7 trillion per year in total global premiums. I suspect the U.S. share would be at least \$500 billion per year, year in and year out.⁵ Of course, we would have to be careful not to exempt any kind of transaction: It would only invite our financial wizards to build new instruments based on the exempted activity.

You want to speculate against currencies? You want to dive in and out of the markets every few nanoseconds? You want to buy and sell credit default swaps and CDOs? Go to it. But on each transaction you've got to pay an insurance premium to the public. Why? Because history has taught us that at some point the activity you are engaging in will contribute to the next financial sector bust, and we'll have to suffer the damage and clean up the mess.

But won't this encourage even more of a moral hazard, since the financial community would know a bailout would be coming? First, these funds should not be designated for bailouts. They should be used to help us rebuild the economy after financial turmoil. When I say we need "financial disaster insurance," I don't mean that this is insurance the financial industry pays to protect itself. I mean insurance that protects us from the financial industry, paid for by the industry since it is the source of potential harm. This is like medical malpractice insurance. Doctors and hospitals pay for malpractice insurance to cover the cost to a patient if they have caused that patient harm.

Because of the critical role of the financial sector, when it malfunctions the entire economy suffers. We need income to help us survive the economic crashes since no one yet has figured out how to have private capital markets and not to have booms and busts.

But will this fund eliminate the need for bailouts of failed banks and systemically important financial institutions? No, but it might reduce their frequency by draining excess capital from financial markets and moving it into the real economy. We can't promise, nor can anyone else, that after this crisis, public money won't again be used to save the financial system. But in the meantime, under our financial disaster insurance plan, we'd be getting revenue to build a stronger real economy.

But shouldn't the fees depend on the instrument and its level of risk? No. Such micromanaging is asking for trouble. It would be hard to determine the risk profiles and it would be even harder to figure out how to translate them into a fee structure. But more importantly, such differentiation would be red meat for the derivative industry. Inventive quants and lawyers would certainly work long, hard hours to devise new instruments that avoided the higher fees and qualified for the lower ones.

In the United States, I would urge that the insurance premiums—the \$500 billion or so each year—go directly to repair Main Street: for renewable energy, infrastructure, health care, and education—the most vital real investments a society can make. Again, we are not calling for the fund to be set aside to bail out the financial industry. Instead we're asking that the fund prop up the real economy that will, sooner or later, suffer, as we are suffering now, from collapsing financial markets. Again, we are draining money from the fantasy-finance casino and moving it toward the real economy.

But isn't financial disaster insurance really a tax? It's both. It is a tax because it moves money from the private financial sector to the public's coffers, as all taxes do. It is insurance because, acting collectively through our government, we are trying to insure

ourselves from the economic damage done when the financial sector gets into serious trouble, which it is prone to do with great regularity. We need the tax/insurance because no one can possibly assure us that our current disaster will end anytime soon, or that another one won't befall us in the next decade or two. No one can provide us with real collateral to back up the claim that regulation will prevent the next meltdown. At this point in human history, we'd be very naïve to believe that we can prevent free-market bubbles through regulations or more consumer protections and support. To ignore our boom-and-bust history is to engage in another round of bubble thinking, of irrational exuberance, of faith-based economics. Regulations will always be imperfect. And financial wizards are notoriously ingenious when there are billions of chips on the table. With financial-disaster insurance, they'll have to slide some chips our way each and every time they spin the wheel. The insurance premiums/tax should be viewed as the price financial institutions must pay for free financial markets, above and beyond income taxes, which all of us should pay as citizens.

Is this practical? Won't financial markets, which are electronic, just move to areas with no insurance premiums? This is a vexing problem that will require a great deal of diplomacy to solve. But it should be worth the effort. This proposal works best if the world's economic powers—offshore islands as well—join in a global insurance program. Financial markets connect us all. The tsunamis are truly global. And every nation has an interest in insuring itself from fantasy finance.

The core of this idea is not original. James Tobin (1918–2002), a Nobel laureate and Yale economist, proposed a global tax of 1 percent on the transfer of currencies between countries. He believed that this tax (which became known as the Tobin tax) would limit currency speculation, which can destabilize the financial system and several times has caused extreme hardship in developing nations. He also hoped funds collected through the tax would be used to eradicate poverty.