

# Opinion

Why small towns hold the key to the White House

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## Save the world? Hank just didn't have a clue

The staggering incompetence of the US Treasury Secretary is now acknowledged – and is a disaster for George Bush

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**T**he Emperor has no clothes. If you want to know why American capitalism is on the brink of disaster, but also want to understand what will save it, then log on to the C-Span congressional website and watch the interrogations of Henry Paulson, the US Treasury Secretary, by the Senate and House banking committees.

Until last week, I was in a minority of one in arguing that Mr Paulson was personally responsible for suddenly turning the painful but manageable credit crunch that had been grinding away 18 months in the background of the US economy into a global catastrophe. Mr Paulson's appearances on Capitol Hill, marked by the characteristic Bush-era combination of arrogance and incompetence, are turning my once-outlandish view into conventional wisdom: Henry Paulson is to finance what Donald Rumsfeld was to military strategy, Dick Cheney to geopolitics and Michael Chertoff to flood defence.

Mr Paulson may be a former chairman of Goldman Sachs, but as US Treasury Secretary he does not know what he is doing. His recent blunders, starting with the "rescue" of Fannie Mae, have triggered unintended consequences around the world, resulting in the death-spiral of financial values. But last Friday Mr Paulson outdid even these

Rumsfeldian achievements, when he demanded \$700 billion from Congress for a "comprehensive and fundamental" solution to the global financial crisis, without apparently having any idea of what he would actually do.

The good news — before I return to the perils of Mr Paulson — is that his blunders no longer matter very much. There will still be a huge US government bank bailout, which will probably avert a disastrous slump in the US and global economies. But because Mr Paulson has lost the political initiative, this bailout will now be led by the Democratic leadership in Congress and will be structured around its priorities — relief from mortgage foreclosures, restrictions on bankers' pay and big government shareholdings in US banks. For President Bush it is a disaster, dashing his last faint hope of having a tangible achievement to his name before he leaves office.

How did things come to such a pass? When Mr Paulson announced his \$700 billion "plan" last Friday, everybody in the financial world (myself included) heaved a sigh of relief. Finally, it seemed, the US Government was going to do whatever it takes to stabilise the world financial system. The universal assumption was that Mr Paulson would present a detailed plan of action over the weekend, putting a safety net under the value of homes, mortgages and related assets. Yet all that appeared by Saturday evening was a three-page legislative outline, with no hint of the mechanisms to be used. The only substantive clause in the draft was a swaggering demand for untrammelled power: "Decisions by the Secretary pursuant to this Act are non-reviewable and may not be

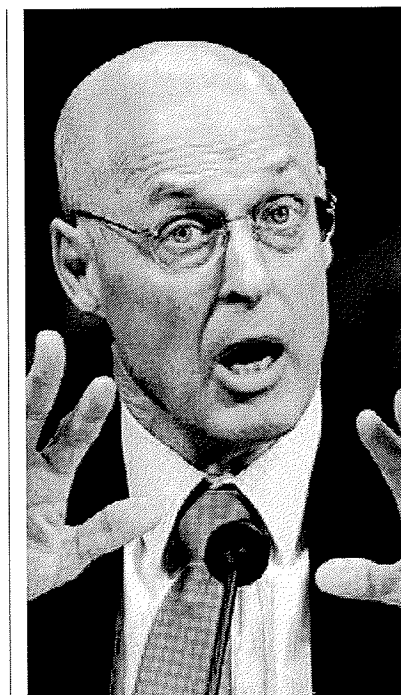
reviewed by any court of law or any administrative agency."

When further details of the Paulson plan failed to appear on Sunday it was assumed that the details were being untangled in late-night political negotiations. When there was still no plan on Monday, the view was that Mr Paulson must be holding back the details for his testimony to the Senate Banking Committee the following day. But then, to everyone's astonishment, Mr Paulson turned up to the committee on Tuesday morning with only the briefest opening statement, which simply repeated what he had already said the week before: the sky was falling and the only way to stop it was to give him authority over \$700 billion in public money, to be spent in unspecified ways.

And suddenly the sky did fall down — not on the world economy, but on Mr Paulson. Consider the reactions from American politicians, including Republicans: "Stunning and unprecedented in its lack of detail" ... "a \$700 billion blank cheque to Wall Street" ... "neither workable nor comprehensive" ... "foolish waste of massive taxpayer funds" ... "eerily similar to the rush to war in Iraq". Best of all was John McCain's comment: "When we're talking about a trillion dollars of taxpayer money, 'trust me' just isn't good enough."

At first, nobody could quite believe Mr Paulson was incompetent. Was it really possible that the Treasury Secretary had no idea of what to do with this unprecedented financial firepower? Perhaps his silence on crucial issues such as what he would pay for the banks' "troubled assets" was just a tactical ruse.

But as the cross-examination rolled



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on, and Mr Paulson just waffled — "we will ask experts to advise us", "we will get the best and brightest financiers to suggest ideas" — the terrible truth dawned. There was no such thing as a Paulson plan. Not only did Mr Paulson not know what he was doing. He did not know what he was talking about. When pressed to offer at least some basic principles for his rescue, Mr Paulson had no answers. When challenged about limits to executive remuneration and taxpayer stakes in future profits of participating banks, he brusquely rejected all such proposals — on the amazing ground that they might

discourage some of the stronger banks from taking advantage of government support!

Could he really be so clueless? Surely not. Why, then, has Mr Paulson failed? His inability to think seriously about solutions to the present financial crisis probably has deep ideological roots. Just as Mr Rumsfeld could simply not believe that US foreign policy might be misguided, Mr Paulson simply cannot believe that markets can be fundamentally wrong. He therefore cannot imagine, for example, that government judgments about the value of bank securities may, in some circumstances, reflect economic realities more accurately than market prices. Since some such recognition of market failure is fundamental to any understanding of banking crises, it is not surprising that Mr Paulson finds it difficult to come up with a credible solution.

The ideological pendulum is now swinging but what is needed to avoid future crises is not necessarily more regulation. It is better-quality regulation, managed by people who understand and respect markets but do not worship them. Markets are usually right, but sometimes they are dangerously wrong — and they need to be managed with decisive and competent government intervention.

The people who do not understand the role of government should not be regulating markets any more than they should be fighting wars or managing flood defences.

P. J. O'Rourke, the conservative writer, once remarked: "The Republicans are a party that says government doesn't work — and then get elected and prove it." This should be the epitaph for the Bush Administration — and Mr Paulson.