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Leaders Without Followers

The Paulson Plan and the week that was.

by Lawrence B. Lindsey

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Just over a week ago the collapse in credit markets forced the secretary of the Treasury to assemble a bipartisan group from both houses of Congress to sell a record-setting government-bailout plan of the financial industry. Trouble was no such plan existed at the time of the meeting. He set off a mad scramble to come up with the barest outlines of a plan on Saturday followed by two Democratic outlines, one for the House and one for the Senate, on Sunday.

By Monday the 22nd, it was obvious to markets and most other observers that, when it came to the plans, there was not a lot of "there" there. Unintended consequences multiplied. So, when Henry Paulson and Federal Reserve chairman Ben Bernanke began their gauntlet of testimonies on Tuesday, the mood was intensely skeptical, even bordering on hostile. Equity markets crashed. Credit markets seized up again on Wednesday, even though stocks stabilized.

By Thursday stocks had rallied on expectations that Congress would pass a bill by the end of the weekend. Democrats announced they had an agreement amongst themselves, but their rank and file were decidedly not on board. Nonetheless, the president arranged a seal-the-deal ceremony for Thursday afternoon at the White House with the congressional leadership and both McCain and Obama present. It was to be followed by a photo opportunity with the current president and the two men who might succeed him collectively blessing a bailout package.

It was not to be.

Senator Richard Shelby, deeply suspicious of the Paulson plan, left the meeting early and declared there was no deal. Obama headed for the Mayflower Hotel to hold his own press conference. The Democratic leadership focused on mocking McCain, blaming him for the failure, a narrative that the media parroted, ignoring the fact that if what the Democrats claimed was true, they had the votes to pass the law.

Still, as of this writing on Friday night, a bill was almost certain to get passed. The Democratic congressional leadership and the White House have had a "Continuing Resolution" strategy in their back pocket all along. The plan was to roll goodies for the auto industry and other special interests, a "safety net" package, and the latest version of the Paulson plan in with authority for the government to spend money after midnight on Tuesday. The alternative would be a government shut down.

Thus stands the state of governance of the greatest economic power in the history of the world. And on this basis politicians claim that what is needed is more regulation by government.

The central problem of the deal was that it takes a commanding heights approach. The key beneficiaries are to be the very largest New York-based financial institutions and a few billionaires like Warren Buffett and Bill Gross. Buffet even said as much. He plunked down a cool $5 billion to buy preferred stock yielding 10 percent in Paulson's old firm, Goldman Sachs, saying he was confident that Congress would pass the Paulson bailout bill.

The plan had a commanding heights problem in the Congress as well. The Democratic leadership, including committee chairmen Barney Frank, Chris Dodd, and Chuck Schumer, were enthusiastic. But it was hard to find an ordinary member who exuded confidence. The president gave a prime-time speech to push the bill on Wednesday night. It was a good performance, but on Thursday morning it wasn't any easier to find Republican congressmen who supported the plan.

But the greatest commanding heights problem was that the plan had virtually no public support. Congressmen reported record-breaking email and phone calls from constituents, running as much as 300 to 1 against. The public saw it as a bailout of Wall Street. What had not been explained was how bailing out Wall Street would also help them. There is a good case that could be made on that score, but it hasn't been.

Ultimately the bill will be a missed opportunity. No one with experience in these matters believes the Treasury purchase plan is workable. It will take weeks, maybe months, to set up-not something that makes sense when the country is allegedly teetering on a precipice. The plan, moreover, should have been accompanied with measures that would stabilize the banking sector and prevent any possiblity of a bank run. On Thursday night the FDIC did a forced sale of Washington Mutual to J.P. Morgan just to avoid the potential disaster of the bank runs that would follow if uninsured depositors were not protected. Eighteen billion had left WaMu in the days leading up to the purchase. On Friday a similar run began on Wachovia. In this environment, not removing the deposit insurance cap could be a recipe for disaster, more than undoing any possible benefits from the legislation.

When the people atop the commanding heights of the economy think that they know best, and their followers' concerns are ignored, problems inevitably follow. We can only hope that America will be spared relearning this lesson of history, too painfully, this time around.

--Lawrence B. Lindsey, for the Editors