

3 February 2010

# Today's Tabloid

PERSONAL NEWS FOR [Ign@limitedgovernmentnetwork.com](mailto:Ign@limitedgovernmentnetwork.com)

FISCALLY CONSERVATIVE BLOG FEEDS

## When Individuals Form Corporations, They Don't Lose Their Rights [Cato at Liberty]

FEB 02, 2010 07:45P.M.

By Ilya Shapiro

The blogosphere has been abuzz on the heels of the Supreme Court's landmark *Citizens United* opinion. Hysterical criticisms of the speculative changes to our political landscape aside — including the President's misstatements in the State of the Union — one of the most common and oft-repeated criticisms is that the Constitution does not protect corporations. Several "reform" groups have even drafted and circulated constitutional amendments to address this concern.

This line of attack demonstrates a fundamental misunderstanding of both the nature of corporations and the freedoms protected by the Constitution, which is exemplified by the facile charge that "corporations aren't human beings."

Well of course they aren't — but that's constitutionally irrelevant: Corporations aren't "real people" in the sense that the Constitution's protection of sexual privacy or prohibition on slavery make no sense in this context, but that doesn't mean that corporate entities also lack, say, Fourth Amendment rights. Or would the "no rights for corporations" crowd be okay with the police storming their employers' offices and carting off their (employer-owned) computers for no particular reason? — or to chill criticism of some government policy.

Or how about Fifth Amendment rights? Can the mayor of New York exercise eminent domain over Rockefeller Center by fiat and without compensation if he decides he'd like to move his office there?

So corporations have to have *some* constitutional rights or nobody would form them in the first place. The reason they have these rights isn't because they're "legal" persons, however — though much of the doctrine builds on that technical point — but instead because corporations are merely one of the ways in which rights-bearing individuals associate to better engage in a whole host of constitutionally protected activity.


That is, the Constitution protects these groups of rights-bearing individuals. The proposition that only human beings, standing alone, with no group affiliation whatsoever, are entitled to First Amendment protection — that "real people" lose some of their rights when they join

together in groups of two or ten or fifty or 100,000 — is legally baseless and has no grounding in the Constitution. George Mason law professor Ilya Somin, also a Cato adjunct scholar, discusses this point here.

In any event, as Chief Justice Roberts said in his *Citizens United* concurrence: "The First Amendment protects more than just the individual on a soapbox and the lonely pamphleteer." Justice Scalia makes the same point, explaining that the text of the Constitution "makes no distinction between types of speakers." The *New York Times* isn't "an individual American" but its speech is still protected under the First Amendment (regardless of any exemption for "media corporations" — whatever those are in a world where conglomerates own interests not limited to media, not to mention the advent of blogs and other "new" media).

A related line of attack is that individuals acting through corporations should be denied their freedom of speech because corporations are "state-created entities." The theory goes that if a state has the power to create corporations, then it has the power to define those entities' rights. Somin rebuts the weakness of this argument here, correctly pointing out that nearly every newspaper and political journal in the country is a corporation.

In short, the contention that the First Amendment does not protect corporations ignores the fact that there is no constitutional difference between individuals and groups of individuals, however organized. Still, I give credit to the groups who are proposing constitutional amendments that would limit corporate rights: at least they recognize that, after *Citizens United*, there is no basis upon which to argue that the First Amendment does not protect corporate political speech. The Free Speech Clause, after all, is blind as to the nature of the speaker.

For further concise refutations of the basic arguments against *Citizens United*, see here (points 3-6 address issues relating to corporations and their rights). 

FISCALLY CONSERVATIVE BLOG FEEDS

## Obama's Troubles and U.S. Foreign Policy [Cato at Liberty]

FEB 02, 2010 07:44P.M.

By Christopher Preble

At their National Security Experts blog, *The National Journal* asks:

President Obama is in a rough political patch...So, what does his weakened position mean for his handling of foreign affairs and for the tack that allies, rivals and outright enemies take toward the U.S.?

I respond:

I don't believe that the president will rely on a major foreign policy initiative to turn around his political fortunes. He has many things on his plate right now. He spent just nine minutes on foreign policy in the SOTU, and the American people have clearly signaled a desire to focus on problems here at home.

I'm not entirely happy with this turn of events. I think the country's turn inward — in the form of trade protectionism, nativism, and anti-immigrant sentiment — is particularly worrisome. But the wise course for those in Washington is to come up with a foreign policy that can be sustained with a modicum of popular support. They should find a way for us to be engaged in the world without being in charge of it.


So far, I see no evidence of a change away from the assumptions that have guided U.S. foreign policy through four post-Cold War administrations, two Republican and two Democrat (plus GHW Bush for part of his term). The just released QDR repeats many of the same mantras about U.S. power as a global public good that we've heard for years.

Up to now, the practice has been to distort and confuse the purpose of U.S. foreign policy. The policy elite in Washington and New York know that the public expects the U.S. military to be used to advance American security, when in fact much of what it does underwrites the security of others. As Michael Mandelbaum wrote several years ago, "To make sacrifices largely for the benefit of others counts as charity, and for Americans, as for other people, charity begins at home."

Obama and his team, and probably his successor, might manage to sustain the dominant posture for a while longer. Other countries have no great desire to assume responsibilities for their own defense, or for policing their respective regions.

But at the end of the day, all politics is local. Americans can't be expected to care more about things that occur 8,000 miles from our shores than they do about things in the Gulf of Mexico, or in New Mexico. In an era of crushing fiscal imbalance, and an increasingly complex international

environment, now is the time to revisit some of the core assumptions of the past two decades and ask: Is this where we want to be 20 years from now, with the U.S. military still the world's policeman, and with the rest of the world anxious, querulous and resentful when we use that power, or even when we don't?

If we choose to make a change, even a modest change in the direction of greater burden sharing with allies who have grown too comfortable under the U.S. security umbrella, we might look back on this period fondly. If we don't, we are likely to see it as a missed opportunity. 

FISCALLY CONSERVATIVE BLOG FEEDS

## Robert Gates, Meet Robert Gates [Cato at Liberty]

FEB 02, 2010 07:40P.M.

By Justin Logan



"If the Department of Defense can't figure out a way to defend the United States on a budget of more than half a trillion dollars a year, then our problems are much bigger than anything that can be cured by buying a few more ships and planes."

- Defense Secretary Robert Gates, Speech to Economic Club of Chicago, July 16, 2009

"The situation out there in the world doesn't change and the world is getting more dangerous rather than less so. The Defense Department certainly spends a lot of money but if you look at where the Defense Department is today it certainly is within historical norms."

- Defense Secretary Robert Gates, responding to suggestions that his new \$741 billion budget should be cut, February 2, 2010 

FISCALLY CONSERVATIVE BLOG FEEDS

## Is the Threat of Cyberattack Growing? [Cato at Liberty]

FEB 02, 2010 07:36P.M.

By Jim Harper

The *New York Times* dutifully reports that the Director of National Intelligence says it is. But it's hard to know what that means. The word "cyberattack" has no usefully fixed definition.

And the important questions—plural—include: 1) whether cyberattacks—plural—are growing in number and sophistication more quickly than the capability of infrastructure owners to fend them off and recover from them; 2) which, if any, owners lack incentives to secure their infrastructure and what security externalities they might create; and 3) what levers—such as contract liability, tort liability, or regulation—might correct any such market failures.

Some lines in Director Blair's statement are quite telling. Compare this:

Terrorist groups and their sympathizers have expressed interest in using cyber means to target the United States and its citizens.

to this:

The cyber criminal sector in particular has displayed remarkable technical innovation with an agility presently exceeding the response capability of network defenders.

Now, which class of actors are you going to worry about—the ones that dream of doing something bad? Or the ones that have the sophistication to do something bad? Probably the latter.

While calling for a federal intelligence-community role in "cybersecurity," Blair confesses that this is more of a crime problem that the business sector needs to handle than a true national security issue in which the leading role would be played by government.


The good news is that crime syndicates don't prosper by killing their hosts. Don't look for catastrophic failure of our technical infrastructures arising from this most serious of "cyber" threats.

There's no question that cybersecurity is important. But it's also manageable. I shared my thoughts on "cybersecurity" last year with the House Science Committee. 

FISCALLY CONSERVATIVE BLOG FEEDS

## The Obama Budget and Small Business [Americans for Tax Reform]


FEB 02, 2010 04:32P.M.

President Obama today is touting all the advantages his budget has for small businesses. In particular, he's talking about using TARP funding (supposedly temporary, to be paid back to taxpa... 

FISCALLY CONSERVATIVE BLOG FEEDS

## Administration Pushes Ahead With Internet Takeover [Americans for Tax Reform]

FEB 02, 2010 04:12P.M.

As if the disappointment of the budget wasn't enough, supporters of a free and robust economy were again disappointed yesterday when President Obama, in his "youtube" interview, st... 

FISCALLY CONSERVATIVE BLOG FEEDS


## The College Earnings Premium — Why It's Meaningless [Cato at Liberty— Why It's Meaningless]

FEB 02, 2010 03:48P.M.

By Andrew J. Coulson

The *WSJ* reports today on the average lifetime earnings advantage conferred by a college degree. This statistic is probably worse than useless. "College" isn't a single thing, and its benefits will not likely be enjoyed equally by every single student, even those pursuing precisely the same degrees.

For a college earnings premium figure to be of any value to policymakers or prospective college students, it would be necessary to break it down by field and by student characteristics. What's the premium difference, for instance, between workers who majored in engineering, chemistry, computer science, mathematics, economics, etc., compared to those who majored in communications, art history, social work, multicultural studies, etc.? A similar breakdown of interest would be by SAT score.

These breakdowns would help people to make better informed decisions. An overall earnings premium estimate may well be worse than nothing: leading to great over- or underestimates for the value of a particular college degree to a particular student. 

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FISCALLY CONSERVATIVE BLOG FEEDS

## Time to Lose the Trade Enforcement Fig Leaf [Cato at Liberty]

FEB 02, 2010 03:46P.M.

By Daniel Ikenson

During his SOTU address last week, the president declared it a national goal to double our exports over the next five years. As my colleague Dan Griswold argues (a point that is echoed by others in this *NYT* article), such growth is probably unrealistic. But with incomes rising in China, India and throughout the developing world, and with huge amounts of savings accumulated in Asia, strong U.S. export growth in the years ahead should be a given—**unless we screw it up with a provocative enforcement regime.**

The president said:

If America sits on the sidelines while other nations sign trade deals, we will lose the chance to create jobs on our shores. But realizing those benefits also means enforcing those agreements so our trading partners play by the rules.

Ah, the enforcement canard!

One of the more persistent myths about trade is that we don't adequately enforce our trade agreements, which has given our trade partners license to cheat. And that chronic cheating—dumping, subsidization, currency manipulation, opaque market barriers, and other underhanded practices—the argument goes, explains our trade deficit and anemic job growth.

But lack of enforcement is a myth that was concocted by congressional Democrats (Sander Levin chief among them) as a fig leaf behind which they could abide Big Labor's wish to terminate the trade agenda. As the Democrats prepared to assume control of Congress in January 2007, better enforcement—along with demands for actionable labor and environmental standards—was used to cast their opposition to trade as conditional, even vaguely appealing to moderate sensibilities. But as is evident in Congress's enduring refusal to consider the three completed bilateral agreements with Colombia, Panama, and South Korea (which all exceed Democratic demands with respect to labor and the environment), Democratic opposition to trade is not conditional, but systemic.

The president's mention of enforcement at the SOTU (and his related comments to Republicans the following day that Americans need to see that trade is a two way street — starts at the 4:30 mark) indicates that Democrats believe the fig leaf still hangs. It's time to lose it.

According to what metric are we failing to enforce trade agreements? The number of WTO complaints lodged? Well, the United States has been complainant in 93 out of the 403 official disputes registered with the WTO over its 15-year history, making it the biggest user of the dispute settlement system. (The European Communities comes in second with 81 cases as complainant.) On top of that, the United States was a third party to a complaint on 73 occasions, which means that 42 percent of all WTO dispute settlement activity has been directed toward enforcement concerns of the United States, which is just one out of 153 members.

Maybe the enforcement metric should be the number of trade remedies measures imposed? Well, over the years the United States has been the single largest user of the antidumping and countervailing duty laws. More than any other country, the United States has restricted imports that were determined (according to a processes that can hardly be described as objective) to be "dumped" by foreign companies or subsidized by foreign governments. As of 2009, there are 325 active antidumping and countervailing duty measures in place in the United States, which trails only India's 386 active measures.

Throughout 2009, a new antidumping or countervailing duty petition was filed in the United States on average once every 10 days. That means that throughout 2010, as the authorities issue final determinations in those cases every few weeks, the world will be reminded of America's fetish for imposing trade barriers, as the president (pursuing his "National Export Initiative") goes on imploring other countries to open their markets to our goods.

Rather than go into the argument more deeply here, Scott Lincicome and I devoted a few pages to the enforcement myth in this overly-audaciously optimistic paper last year, some of which is cited along with some fresh analysis in this Lincicome post.

Sure, the USTR can bring even more cases to try to force greater compliance through the WTO or through our bilateral agreements. But rest assured that the slam dunk cases have already been filed or simply resolved informally through diplomatic channels. Any other potential cases need study from the lawyers at USTR because the presumed violations that our politicians frequently and carelessly imply are not necessarily violations when considered in the context of the actual rules. Of course, there's also the embarrassing hypocrisy of continuing to bring cases before the WTO dispute settlement system when the United States refuses to comply with the findings of that body on several different matters now. And let's not forget the history of U.S. intransigence toward the NAFTA dispute settlement system with Canada over lumber and Mexico over trucks. Enforcement, like trade, is a two-way street.

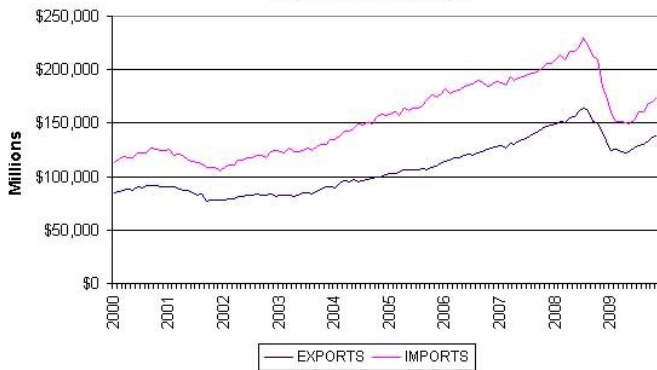
And sure, more antidumping and countervailing duty petitions can be filed and cases initiated, but that is really the prerogative of industry, not

the administration or Congress. Industry brings cases when the evidence can support findings of "unfair trade" and domestic injury. The process is on statutory auto-pilot and requires nothing further from the Congress or president. Thus, assertions by industry and members of Congress about a lack of enforcement in the trade remedies area are simply attempts to drum up support for making the laws even more restrictive. It has nothing to do with a lack of enforcement of the current rules. They simply want to change the rules.

In closing, I'm happy the president thinks export growth is a good idea. But I would implore him to recognize that import growth is much more closely correlated with export growth than is heightened enforcement. The nearby chart confirms the extremely tight, positive relationship between export and imports, both of which track similarly closely to economic growth.

**Monthly U.S. Import and Export Value**  
January 2000 - November 2009

Bureau of Economic Analysis



U.S. producers (who happen also to be our exporters) account for more than half of all U.S. import value. Without imports of raw materials, components, and other intermediate goods, the cost of production in the United States would be much higher, and export prices less competitive. If the president wants to promote exports, he must welcome, and not hinder, imports. 🇺🇸

FISCALLY CONSERVATIVE BLOG FEEDS

## Volcker Rule misses the Mark [Cato at Liberty]

FEB 02, 2010 02:15P.M.

By Mark A. Calabria

Today Paul Volcker appears before the Senate Banking Committee to argue for the separation of proprietary trading and commercial banking. In Mr. Volcker's own words "what we plainly need are authority and methods to minimize the occurrence of those failures that threaten the basic fabric of financial markets."

Using his own test, the Volcker Rule fails miserably. Had this rule been in place say five or even ten years ago, we'd most likely be in the same place we are today. It would have not avoided the crisis, and may potentially have made it worse.

First of all the proposal ignores the fact that those institutions at the heart of the crisis, Bear, Lehman, Fannie, Freddie, AIG, were not commercial banks. They were not using federally insured deposits to gamble in our financial markets. Those commercial banks with proprietary trading activities that did fail, such as Wachovia, were sunk not by proprietary trading, but by bad mortgage lending.

Mr. Volcker is correct in arguing for a change in assumptions that institutions and their creditors will not be bailed out. He errs in believing that the House passed financial "reform" bill achieves that. One has to wonder if he's bother to even read the bill. The House bill explicitly allows for rescuing creditors. The House bill does not reduce the chance of bailouts, it increases them.

While the Obama Administration may have changed the face of its reforms, sadly the substance of its proposals continue to bear little relation to the actual causes of our financial crisis. Nowhere in the President's proposals do we see any efforts at avoiding future housing bubbles. Perhaps this should come as no surprise given Washington's continued attempts to re-inflate the last housing bubble. 🇺🇸

FISCALLY CONSERVATIVE BLOG FEEDS

## Taxing the Rich Won't Work

### [Cato at Liberty]

FEB 02, 2010 12:40P.M.

By Alan Reynolds

The new budget reportedly hopes to raise \$364 billion over ten years by raising the top two tax rates, plus \$105 billion by raising the tax on dividends and capital gains to 20% from 15%, and \$500 billion through discriminatory caps and limits on personal exemptions and deductions allowed to other taxpayers.

The \$364 billion from raising the top two tax rates pales in comparison to the \$2.56 trillion from keeping the rest of the Bush tax cuts in place, including \$600 per couple (the 10% bracket) for everyone still rich enough to pay taxes (the Obama plan would exempt half of U.S. workers from paying income tax). That contrast between \$364 billion and \$2.56 trillion is definitive proof that Democrats' endless complaint about the Bush tax cuts going "mainly to the rich" was one of the biggest big lies of the past decade.

The President's urge to penalize mature, two-earner educated couples earning more than \$250,000 is symbolic populism, having essentially *nothing to do with reducing the deficit*. Table S-2 of the Budget (p. 147) lists "Upper-income tax provisions dedicated to deficit reduction" as *just \$34 billion in 2011* — less than 1% of estimated spending of \$3.8 trillion. Errors in estimating next year's deficit have often been *much* larger than \$34 billion, particularly during the early stages of economic recoveries.

Still, the false belief that higher tax rates on the rich could eventually raise significant sums over the next decade is a *dangerous delusion*, because it means long-term deficits are seriously *understated*.

Here are just a few reasons why punitive marginal tax rates on high-income families cannot possibly raise even the *relatively* trivial sums the Budget is counting on:


1. Professionals and companies who currently file under the individual income tax (including most trial lawyers and hedge fund managers) would form C-corporation to shelter income, because the *corporate* tax rate would then be lower with fewer arbitrary limits on deductions for costs of earning income.
2. Investors who jumped into dividend-paying stocks in 2003 when the tax rate fell to 15% would dump some of those shares in favor of tax-free *municipal bonds* if the dividend tax went up, and keep the rest in tax-free IRA or 401k accounts. Prices of dividend-paying stocks and funds could be depressed, reducing the yield of the capital gains tax.
3. If faced with a higher capital gains tax next year, investors would rush to realize *taxable* capital gains (those not in IRAs and 401ks) later *this* year. After 2010, investors would make greater efforts to avoid realizing

gains in taxable accounts unless they had offsetting losses, and they would also make fewer investments in assets subject to the capital gains tax.

4. Many two-earner couples would become one-earner couples, early retirement would become more popular, physicians would play more golf, etc.

That is a small sampling of known *behavioral responses* which economists call "the *elasticity of taxable income*" or ETI for short. What that means is this: When the marginal tax rate goes up, the amount of reported incomes goes down. As a forthcoming study by Joel Slemrod, Seth Giertz and Emmanuel Saez concludes, "*There is much evidence to suggest that the ETI is higher for high-income individuals who have more access to avoidance opportunities.*"

I presented a 60-page paper in 2008 full of graphs and tables, many derived from the tax data of Thomas Piketty and Emmanuel Saez, offering undeniable evidence that static revenue estimates (which ignore or minimize the ways in which people react to higher tax rates) greatly exaggerate potential revenue from higher tax rates on individual salaries, dividends and capital gains.

I concluded, "There is a serious fiscal risk in the future that overly-optimistic revenue estimates based on the assumption of zero or 0.25 elasticity of taxable income could lead the federal government to make long-term spending plans on the basis of phantom revenues from higher tax rates, embarking on major new entitlement programs (in the guise of refundable tax credits) in the false hope that these static or nearly-static revenue estimates are realistic." 

FISCALLY CONSERVATIVE BLOG FEEDS

## Debate: Is Obama Failing?

### [Cato at Liberty]


FEB 02, 2010 12:18P.M.

By David Boaz

At the *Economist* website, I'm debating the question, "This house believes that Barack Obama is failing." I'm taking the affirmative. Readers are allowed to vote, and the *Economist's* typically left-leaning readers are voting for Obama by about the same margin that Americans are rejecting his health care plan. So feel free to mosey on over there, read both sides of the argument, and cast your vote. My bottom line:

When your policies aren't working, the voters have noticed and your transformative ideological agenda is moving broad public opinion in the other direction, it's safe to say you're failing.

Rebuttals and closing statements will follow in a few days. But don't

delay! Visit today! 

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FISCALLY CONSERVATIVE BLOG FEEDS

## On CNBC's Kudlow Report Tonight [Larry Kudlow's Money Politic\$]

FEB 02, 2010 12:03P.M.



**This evening at 7pm ET:**

### THE BALLOONING BUDGET

Plus, Geithner in the hot seat...

CNBC's Hampton Pearson reports from Washington.

### BALLOONING BUDGET TAX ATTACK

Rep. Paul Ryan (R-WI) will be aboard with his perspective.

### OBAMA'S TOWN HALL: TAXES & JOBS IN THE SPOTLIGHT

NBC's Steve Handelsman reports.

### FAT CAT TAX - WHAT CONSTITUTES RICH?

- Michael Linden, Center for American Progress Associate Director for Tax and Budget Policy

- Arthur Laffer, Chief Investment Officer, Laffer Investments; Fmr. Reagan Economic Advisor

### BANK TAX ATTACK

Hudson City Bank Corp president & CEO Ron Hermance will join us with his take.

### THE VOLCKER RULE: GOOD IDEA OR BAD?

- Mark Calabria; CATO Director of Financial Regulation Studies; Fmr. Banking Committee Official

- Peter Morici, University of Maryland Robert H. Smith School of Business Prof; U.S. International Trade Commission Fmr. Chief Economist

### MARKETS - BULL OR BEAR?

- Mike Ozanian, *Forbes* National Editor

- James Paulsen, Wells Capital Management Chief Investment Strategist

**Please join us. *The Kudlow Report*. 7pm ET. CNBC.** 


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FISCALLY CONSERVATIVE BLOG FEEDS

## Tuesday Links [Cato at Liberty]

FEB 02, 2010 11:58A.M.

By Chris Moody


- Obama's budget and the \$1 trillion mistake.
- Interesting: Would John Maynard Keynes be a "Keynesian" if he were alive today?
- Justin Logan on the rise of government and central control: "The factor that explains the largest share of the centralism and growth of the American state is war."
- What we can learn from Hugo Chavez: "The lesson for all of us, north and south of the border, is watch our presidents closely, and check them when they try to slip their constitutional bonds."
- "Stimulus Means More Meddling in Education" featuring Adam B. Schaeffer. 

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FISCALLY CONSERVATIVE BLOG FEEDS

## The President's Budget: No Fiscal Restraint in Sight [Americans for Tax Reform]

FEB 02, 2010 11:48A.M.

On Monday, February 01, 2010 President Barack Obama unveiled his budget for Fiscal Year 2011. Despite ongoing verbal nods to the need for fiscal restraint, this budget however delivers little of that... 

FISCALLY CONSERVATIVE BLOG FEEDS

## Globalization: Curse or Cure? [Cato at Liberty]

FEB 02, 2010 10:47A.M.

By Cato Editors

Globalization holds tremendous promise to improve human welfare but can also cause conflicts and crises. How will competition for resources, employment, and growth shape economic policies among developed nations as they attempt to maintain productivity growth, social protections, and extensive political and cultural freedoms?

In a new study, Cato scholar Jagadeesh Gokhale offers policy recommendations for developed nations to reduce globalization's negative effects and, indeed, harness it for solving economic challenges.



FISCALLY CONSERVATIVE BLOG FEEDS

## Illinois Primaries are TODAY [The Club for Growth]

FEB 02, 2010 09:54A.M.

The Chicago Tribune has a site dedicated to today's Chris Cillizza give his final thoughts on the various races.



FISCALLY CONSERVATIVE BLOG FEEDS

## Virginia Senate Votes "NO" on Insurance Mandate [The Club for Growth]

FEB 02, 2010 09:40A.M.

There is a great repudiation of ObamaCare. Measures prompted by the Washington debate are pending in at least 29 states, according to the National Conference of State Legislatures.



FISCALLY CONSERVATIVE BLOG FEEDS

## Heritage's Budget Analysis [The Club for Growth]

FEB 02, 2010 09:16A.M.

Here are some bullet points about Obama and Double the publicly held national debt to over \$18 trillion.



FISCALLY CONSERVATIVE BLOG FEEDS

## The Budget Timeline - Step by Step Sausage Making [The Club for Growth]

FEB 02, 2010 09:11A.M.

Here But if the press does pay attention - especially if the budget gets wrapped up into an omnibus bill - then they will realize that voting in favor of the bill is not in their best interest. This is sausage making at its worst.



FISCALLY CONSERVATIVE BLOG FEEDS

## Obama Budget Assumes Passage of ObamaCare [The Club for Growth]

FEB 02, 2010 08:29A.M.

From the New York Times: President Obama says he has not given up on major health care legislation, and his new budget backs him up. The \$3.8 trillion budget released by the White House on Monday includes \$150 billion in deficit reduction over 10 years on the presumption that a health care bill will be adopted. As a result, it seems that the budget reflects multiple layers of optimism. First, it presumes that despite the bleak outlook at the moment, Democrats will figure out a way to get the legislation approved over fierce Republican opposition. Then, it presumes that the bill will truly reduce future deficits.



FISCALLY CONSERVATIVE BLOG FEEDS

## Obama Budget Still Goes to the Moon [Cato at Liberty]

FEB 02, 2010 07:11A.M.

By Tad DeHaven

The president's new budget proposes to end NASA's Constellation program, a Bush initiative intended to put humans back on the moon by 2020. But Obama's \$3.8 trillion budget still goes to the moon figuratively — if you stacked 3.8 trillion \$1 bills, the pile would reach the moon with 20,000 miles to spare!

The president's proposal to end the Constellation isn't sitting well with those members of Congress who enjoy large NASA spending in their districts. From the *Washington Post*:

“The president's proposed NASA budget begins the death march for the future of U.S. human spaceflight,” Sen. Richard C. Shelby (R-Ala.) said Monday. “If this budget is enacted, NASA will no longer be an agency of innovation and hard science. It will be the agency of pipe dreams and fairy tales.”

Rep. Pete Olson (R-Tex.) said, “This is a crippling blow to America's human spaceflight program.”

Senator Shelby and Rep. Olson exaggerate — the proposal would only end *government* human spaceflight to the moon. Private entrepreneurs are likely to continue pushing into space, especially if we reduce the regulatory and tax burdens.

The administration noted that the Constellation program was “over budget [and] behind schedule,” and that an independent review panel considered it “the least attractive approach to space exploration as compared to potential alternatives.” But this underscores an inherent flaw with a government operating with no legal or constitutional constraints on spending: Congress is generally more concerned with buying special interest support than national need.

While I give kudos to the Obama administration for proposing to end Constellation, they made the wrong decision by not putting the proceeds toward reducing the deficit. Instead, they are proposing that NASA receive a funding increase. A new GAO report on poor acquisition management at NASA, which has been on the GAO's “high risk” list since 1990, shows why the budget increase is unwarranted.

From the GAO:

However, 9 of the 10 projects that have been in the implementation phase for several years experienced cost growth ranging from 8 to 68 percent, and launch delays of 8 to 33 months, in the past 3 years. These 10 projects had average development cost growth of almost \$121.1

million—or 18.7 percent—and schedule growth of 15 months, and a total increase in development cost of over \$1.2 billion, with over half of this total—or \$706.6 million—occurring in the last year.

See this essay for more on cost overruns in government programs. 

FISCALLY CONSERVATIVE BLOG FEEDS

## An Interview with Former Treasury Secretary Henry Paulson [Larry Kudlow's Money Politic\$]

FEB 02, 2010 05:01A.M.

LARRY KUDLOW, host:

Tonight, on a special edition of THE KUDLOW REPORT live from Washington, DC, former Treasury Secretary Henry Paulson talks to us about his new book, “On the Brink: Inside the Race to Stop the Collapse of the Global Financial System.” We will talk to a free market man who engaged in perhaps the most systemic government intervention in US financial history. Did it work? Were there other options? Why is there a populist political backlash against the bailouts? And is the long-term American economic future better or worse? Mr. Paulson will give us some straight talk on what he was thinking and how it all turned out. This is a first government source account, inside account, straight from the horse's mouth. Fasten your seat belts, everybody, THE KUDLOW REPORT begins right now.

Good evening, everyone. I'm Larry Kudlow. Welcome to a special edition of THE KUDLOW REPORT. We are live from Washington, DC. And, yes, we still believe free market capitalism is the best path to prosperity.

Tonight, we're going to have some great fun. We talk to the man who was at the center of the worst worldwide financial crisis since the Great Depression. That man is, of course, former Treasury Secretary and former Goldman Sachs chairman Henry Paulson. His much awaited memoir, “On The Brink: Inside the

Race to Stop the Collapse of the Global Financial System,” just hit bookstores today, and it is climbing the Amazon list very rapidly. It is a first-person account of what Mr. Paulson and others thought was impending financial Armageddon, peering into the abyss with major financial companies failing left and right. All that in the autumn of 2008, a little more than year ago.

KUDLOW: But today as the system is healing, populist anger from the left and the right rails against the rescue mission and the bailouts. The Republican Party has turned against its former Treasury secretary. My question is, why is this? And finally, can the free market system survive all of this. Tonight, we learn about Mr. Paulson’s thinking behind all those decisions, taken in response to the financial crisis, and, ultimately, in the pursuit of long-run American prosperity. Here with me now in Washington, DC, the former Treasury man Henry Paulson.

Hank, thank you very much for doing this.

Mr. HENRY PAULSON: Larry, great to be here.

KUDLOW: First of all, let me say just as someone who read the manuscripts, they were Xeroxed for me, it was one hell of a book. I just want to say that. I loved it, I couldn’t put it down. I read it in the course of three or four days.

Now, let me ask you this. You were here in this very spot in the spring of 2007. We interviewed.

Mr. PAULSON: Yeah.

KUDLOW: And the first stirrings of the crisis began more from reports about subprime mortgage failures and some bank issues. A month or two later, you had the BNP Paribas crisis, which triggered in France. OK. Then you take this narrative down to 2008. Let me ask you this: In ‘07, you said it was containable.

Mr. PAULSON: Right.

KUDLOW: You were still an optimist on the economy. You were still an optimist on the financial system’s health. Why wasn’t it containable?

Mr. PAULSON: Larry, you know, one of the things that I recount in the book is, you know, the very first major meeting I had with President Bush, I

asked for the topic to be about what I thought was the likelihood of having a credit crisis. And he asked me, he said, ‘Hank, what would—well, what would cause it,’ and I said, ‘I don’t know, and we—it’s almost impossible to guess. Who would have guessed that the Russians would default and that would cause a crisis in ‘98? But after the fact, it will be obvious. There’s just a lot of dry tinder out there and I’m not sure what’s going to light the spark.’ Now, why did we say it’s contained? And I think...

KUDLOW: You said it, Mr. Bernanke said it, a lot of people said it.

Mr. PAULSON: Yeah. And I think...

KUDLOW: And then I said it after you said it.

Mr. PAULSON: I know it. I know it. And you’re an optimist.

KUDLOW: I am an optimist.

Mr. PAULSON: Now, in terms of why I thought it was contained was, first of all, I was talking about subprime and we made the mistake of just simply saying the subprime was not big in relation to, you know, a \$13-, \$14 trillion US economy. And what was really going on is we were talking about housing overall, and, you know, since World War II, housing, residential home prices had generally gone up. And mortgages were just considered to be very safe investments. And so the kind of decline we saw was something that was not envisioned in any kind of model. It wasn’t anything that many people that were close to it—you know, after the fact, it all seems obvious to all of us. But the—and so when you had the kind of decline we saw in housing prices, that changed the behavior of those who, you know, of homeowners. And also the other thing you and I were talking about before the show is just this—all of this complexity.

KUDLOW: Mm-hmm.

Mr. PAULSON: And so when...

KUDLOW: These crazy bonds, collateralized debt obligations, credit defaults, what—mortgage-backed securities that were rated triple-A by a bunch of

goofy  
raters that didn't know what they were talking about.

Mr. PAULSON: Yeah. And the level of complexity, OK, made—so when housing the prices declined, all kinds of complex products became suspect because people said, 'Who understands them.'

KUDLOW: All right. So look, let's shift the narrative now. You maybe saw the first sparks of problems back in 2007. Let's call it midyear, to the argument's sake.

Mr. PAULSON: Right.

KUDLOW: Switch it to six or nine months later. March of 2008, Bear Stearns faces a run on the bank. You got to close, them and you sell them to JPMorgan. And as you note in your book, March to September 2008, probably the most extraordinary thing in the history of American finance, eight major financial firms failed, and that doesn't include putting Merrill Lynch inside the Bank of America. In a sense, Merrill would have been nine. And I think we may have a full screen on what the eight were, if we put those things up. But leaving that aside, here, Bear Stearns, IndyMac, Fannie, Freddie, Merrill Lynch acquired by Bank of America. Let's switch to page two on this. We've got to get—AIG's got to come up on there. There's Lehman, AIG. And let's not forget, by the way, Washington Mutual—WaMu—Wachovia and somewheres in there, did I mention IndyMac. That was in there as well. Now...

Mr. PAULSON: And now what you had also happening was...

KUDLOW: That was an incredible jump shift. Incredible in the space of nine months to a year we had a total collapse of all these huge institutions. And yet it seems to come as a great surprise.

Mr. PAULSON: And that's—and that's the US alone because you had—if you look from September through the first part of October, we had six European nations have to come in and rescue a whole series of banks.

KUDLOW: But why? What happened? You had this, in effect, a rolling run on the bank. That's really what you had.

Mr. PAULSON: Right. Yeah.

KUDLOW: You can define it and make it complex...

Mr. PAULSON: Yeah.

KUDLOW: ...but basically you had a run on the bank—investors, depositors—for liabilities that were insured. Open market trading funds and all the rest of it...

Mr. PAULSON: Yeah.

KUDLOW: ...just took off. And all of a sudden you're in this incredible crisis. The credit markets freeze. You couldn't even have bank-to-bank, interbank trading. Money market fund went down, let's not forget that, whatever it was called, the reserve primary fund, that was another.

Mr. PAULSON: Right.

KUDLOW: What happened? Some—there's got to be some rational explanation to get from the middle of those seven into the autumn of '08.

Mr. PAULSON: Well, what you need to understand is what had happened before even the middle of '07, which is you'd had these excesses had been building up for some times. You'd had a—we had been overstimulating housing. So if you look at the combined weight of all of our policies in the US government...

KUDLOW: Wait. It's HUD-backed, unaffordable mortgage loans, Fannie and Freddie?

Mr. PAULSON: What you have—yeah, yeah, Fannie and Freddie, the FHA, various state programs.

KUDLOW: Community Reinvestment Act.

Mr. PAULSON: You know, mortgage interest deduction. I'm not saying of them were...

KUDLOW: Zero capital gains tax on home sales.

Mr. PAULSON: That's right. And so you had—so you had all of this going on, and then you had even more basic than this, you had these big global economic imbalances, structural imbalances, which stem from the fact that we, as a country, save not enough, both as a government and individually.

Overreliant  
on debt. And so this—so you had these big structural imbalances. We  
have a  
tax system that penalizes savings and it really rewards consumption.

KUDLOW: Right.

Mr. PAULSON: And so you had these huge capital flows, global capital  
flows  
raining down through the banks. And so it was something—economists  
would  
talk about this, and they would talk about it, and I remember someone  
even  
using this term that was, you know, “stable disequilibrium,” you know...

KUDLOW: Yeah.

Mr. PAULSON: ...the oxymoron, almost. But—so you had these excesses  
and  
then you have, in 2007...

KUDLOW: Right. Before we get to those, though, I want to say...

Mr. PAULSON: Yeah.

KUDLOW: ...Hank, you were effusive in your praise of Ben Bernanke.

Mr. PAULSON: That's right.

KUDLOW: Effusive.

Mr. PAULSON: Right.

KUDLOW: In a number of pages. You call him the most brilliant guy,  
he's a  
nice man.

Mr. PAULSON: Yeah.

KUDLOW: He shows up on time for meetings. As I recall, you like that,  
too.  
But so many of us believe that the Fed's ultra-easy money, with  
Greenspan  
running the Fed in the early part of the decade, and Bernanke as  
intellectual  
co-pilot, ultra-easy money, ultra-low interest rates, negative real interest  
rates helped the housing bubble, the commodity bubble. And you know,  
as a  
former Wall Street veteran, you throw negative real interest rates at Wall  
Street traders looking for yield to please customers and whatever, that's  
like  
throwing blood into the water for sharks. And so they just took  
those—and  
then I want to ask you, that it comes around—what goes around, comes  
around.

After the Fed finally figures out that they were too easy and the inflation  
rate started rising to 5 or 6 percent, then they tightened the screws from  
pillar to post. And if you look at a chart, real interest rates were 4 or 5,  
6 percent by the time we got to '07, '08. So they pumped the money in,  
they  
bubbled out the asset prices, then they clamped down on them with a  
huge  
liquidity squeeze. Why aren't you more critical of the rock 'n' roll  
monetary  
policy?

Mr. PAULSON: Because what I looked at, and this was—this was my  
view of the  
world, my view of the world was inflation was very low globally, there  
was—the world was awash in excess liquidity, and you saw—so, in this  
world,  
investors were reaching for risk and mispricing it. But to get to your  
basic  
question...

KUDLOW: How easy to misprice when the Fed has mispriced its own  
monetary  
policy?

Mr. PAULSON: Well, when the world's lost—but if you—but to get to  
your  
basic question, because—which I think is critical when you say why did  
you  
get this chain of bank failures suddenly, you had—remember, the crisis  
hit in  
the late July-August period of 2007. So before we got to Bear Stearns,  
this  
had been going on for some time. And the—it was taking its toll. And I  
think that given some of that accounting conventions and so on, the  
losses  
weren't realized.

KUDLOW: Something happened, Hank. Here's the thing that I'm—I  
don't want to  
dwell on this. I mean, your book, your narrative is...

Mr. PAULSON: Yeah.

KUDLOW: ...this was financial Armageddon, peering into the abyss.

Mr. PAULSON: Right.

KUDLOW: And you know what, I don't—I don't disagree. I think you're  
right.  
I'm not sure we need to talk about why the rest of the public today  
doesn't  
understand that. But I'll come back to that. But it seems like when these  
big banks, brokers, mortgage lenders, let's not forget Countrywide went  
down...

Mr. PAULSON: Yeah.

KUDLOW: ...something happened between Bear Stearns and, I don't know, Merrill Lynch, something happened so the system turned off. What was the event that happened?

Mr. PAULSON: Well, I would say that, but first of all...

KUDLOW: Turned a downturn into a catastrophe?

Mr. PAULSON: Well, first of all, again, this had been building up for a long time. These institutions were—there was a—I think they didn't adequately understand the need for liquidity cushions. There was a lot of focus on capital, which is important, but I think they didn't have adequate liquidity. I think it was a complexity of products. But again, they were—I was aware from August of 2007 right up through that period, how severe the problem was.

KUDLOW: Well, I'm not blaming you.

Mr. PAULSON: No, no.

KUDLOW: There's no perfect foresight in this game. I'm not blaming you.

Mr. PAULSON: No. But I was just saying...

KUDLOW: Nobody blames you.

Mr. PAULSON: No, I wasn't...

KUDLOW: The question is, though, in terms of how this thing hit...

Mr. PAULSON: No, I was—I was saying...

KUDLOW: ...what was it? We wake up in the fall of '08, Hank, and it's a total catastrophe.

Mr. PAULSON: See, I was—well, here's the point, I think.

KUDLOW: Something must have happened.

Mr. PAULSON: But here's the point I'm trying to make, which is I think—see, I saw it hitting in August of 2007, and it was beneath the surface. So it was building and building and the system was becoming more and more fragile.

KUDLOW: And you're still going to defend the Fed during this period?

Mr. PAULSON: And it was hard. We were working, yeah, with the Fed, during that period, we were working jointly with the Fed trying to get institutions to raise capital and trying to get them to raise capital while they still could raise some. And I was calling up bankers and saying, I don't know of a single CEO of a major bank or any bank who's ever got in trouble by having too much capital, raising capital. But they viewed it as a sign of weakness.

KUDLOW: All right. We're going to take a break here.

Mr. PAULSON: Yeah.

KUDLOW: I understand that. And I agree with, by the way, the capital issue, and I think that's a key part of this solution. All I'll say is this: Wouldn't it be nice to have a steadier monetary policy that didn't go on, let's take real interest rates. I mean, the inflation rate went to 5 percent for awhile, then it went back down, then it went to 6 percent for awhile in 2006 to 2008. They blew their targets. Wouldn't it be nice to have a central bank and policy that didn't fluctuate from a negative 4 percent real rate to a positive 4 or 5 percent real rate? Because I submit that that was an ocean that drowned—first it created the waters and then took the water out. This was a liquidity squeeze of the first magnitude. First, they pumped it up, then they deflated it. That's got to be part of the issue here.

Mr. PAULSON: Well, I have looked—I'm not trying to debate it. I just looked at, from my perspective and from a banker's perspective, I saw huge complexity, much of it unwarranted. I saw—and I saw big capital flows stemming from imbalances, and with the world awash in that kind of liquidity from the capital flows, and low inflation around the world. So that was, you got it from me, not an economist, not a monetary economist but a banker. And when we were working to put out the fire, you know, I could not have had better partners.

KUDLOW: Well, we'll get to the putting out the fire part. We're going to take a full break. We have Mr. Paulson here for the entire hour. We're going to talk about mark to market accounting, where he's totally going to disagree with me. We're going to talk about the role of the dollar. We're going to talk about Lehman, we're going to talk about AIG. We're going to ask the former secretary whether he, in fact, put a gun to Ken Lewis' head to

buy  
Merrill Lynch. Of course, this is a dramatic book. Somebody's got to figure out the causes of this thing so we can somehow try to prevent it in the future. Coming up, we'll even talk about some of the individual players. I'm Larry Kudlow. Treasury man Henry Paulson. It's a great honor and a pleasure. It's a great read, folks, by the way. You got to go online, buy it, Amazon, bookstores, whatever. Hell of a read. You're watching CNBC, first in business worldwide.

Announcer: You're watching THE KUDLOW REPORT on CNBC. First in business worldwide.

(Announcements)

Announcer: Live from Washington with former Treasury Secretary Henry Paulson, a special edition of THE KUDLOW REPORT.

KUDLOW: All right. We are live with Hank Paulson, talking about his brand-new book. It really is the first inside government account, what I call straight from the horse's mouth.

Hank, thank you. You honor us by this, and it was a terrific book. We're talking about what it was that changed from '07 to '08, the end of '08, when the absolute crisis really started to crash in around us.

I want to ask you about one, and you can disagree with me on this, mark to market accounting. A lot of people, in fact Steve Forbes, the editor-in-chief and publisher of Forbes magazine, he's got another editorial about the subject in this week's Forbes. And he said when the Financial Accounting Standards Board reinstated mark to market accounting, that these banks had to mark to a nonexistent market, that they moved away from cash flow accounting, that the FASB changes, it hadn't been changed since the 1930s. This happened in the middle of 2007. And it just seems a peculiar coincidence that by 2008, as banks had to report terrible earnings because they were marking down their assets as much as 80 percent, this helps trigger the lack of confidence, the run on the banks, and the credit freeze-up.

Mr. PAULSON: Yeah, Larry, I disagree very strongly, and I know that reasonable people disagree on this. But having run an investment bank, I

don't know how to do it if we didn't have the discipline of knowing that every asset had to be marked because I wouldn't know how to do it if you had a different book in terms of what the security is worth from what you would actually—actually paid for it originally. If you had it—the way I think about it is that there is a marvelous discipline about having to say every day what is this...

KUDLOW: Even if there is no real market bid?

Mr. PAULSON: Well, I've got to say...

KUDLOW: Because the opposite is cash flow accounting, right?

Mr. PAULSON: Well...

KUDLOW: They were servicing 70 percent of these bad, toxic loans.

Mr. PAULSON: You can have cash flow accounting, but if something is worth—I would say there's no perfect accounting system. None.

KUDLOW: Hm.

Mr. PAULSON: But to be able to—I just spent too much time in the financial services industry, worked with banks all around the world, looked at what it's like when accounting goes awry and you use historical accounting, and you use that to hide and cover up losses. And the thing that I knew for certain in this—and actually I believe that if there had been more rigid adherence to mark to market accounting, maybe the excesses wouldn't have built up to the point that they built up to, and at least the problem—the problem that I was dealing with in the first part of the crisis was to get banks to recognize losses and raise capital.

KUDLOW: But with respect, at the time—now I'm going to switch to early March of 2009.

Mr. PAULSON: Right.

KUDLOW: And Democratic Congressman Paul Kanjorski and Barney Frank—and you speak very well of Barney Frank in the book.

Mr. PAULSON: Yeah.

KUDLOW: Those two guys really pushed FASB to change mark to

market and go  
back to cash flow accounting.

Mr. PAULSON: Yeah.

KUDLOW: And that was the almost to the day the absolute bottom in the  
stock  
market.

Mr. PAULSON: I...

KUDLOW: Is that just a coincidence?

Mr. PAULSON: You know, it is a coincidence.

KUDLOW: It is a coincidence?

Mr. PAULSON: It is a coincidence. If it were—if it were 72 degrees...

KUDLOW: To the day.

Mr. PAULSON: If it was 72 degrees that day, that would—that would  
have as  
much to do with it.

KUDLOW: All right. A coincidence.

Mr. PAULSON: I've got to tell you, though, one thing I feel strongly is  
that  
politicians should not interfere with accounting. I mean, that is, to me...

KUDLOW: Well, maybe, maybe, you know what? Maybe war is too  
important to be  
left to the generals.

Mr. PAULSON: I think...

KUDLOW: Maybe...

Mr. PAULSON: But...

KUDLOW: Maybe this is too important to be left to the accountants.

Mr. PAULSON: Account...

KUDLOW: Because they took a long-run view. The banks are going to get  
out of  
this in the long run.

Mr. PAULSON: Yeah, the long...

KUDLOW: Maybe.

Mr. PAULSON: I still remember going up to the Hill and having  
meetings where

I would say—where I had a number of congressmen say, 'The banks in  
my  
district don't have a problem, they don't have losses, they've just got  
problems with this mark to market accounting.' And—or—and I felt like  
saying, 'Do you know what you've just said to me? You've just said  
they've  
got losses, but they want to hide them.' And you know...

KUDLOW: Well, some people think there are different ways—look...

Mr. PAULSON: Yeah.

KUDLOW: ...if you're servicing the loan, even though it's temporary  
value,  
you know, you have the—if its temporary value comes down, but you're  
servicing the loan, why is that a bad loan?

Mr. PAULSON: Well...

KUDLOW: And by the way, it works in reverse. During the bubble, those  
loans  
were overvalued because of mark to marketing accounting and...

Mr. PAULSON: Can I just say...

KUDLOW: ...everybody got fat and happy.

Mr. PAULSON: I'll just say one other thing. I would look at things where  
a  
bank would have it on its balance sheet in one place and, you know, a  
historical value, and they'd be trading the same loans, you know, in the  
broker deal...

KUDLOW: Well, I agree with that.

Mr. PAULSON: ...for...

KUDLOW: That's a—yes.

Mr. PAULSON: ...60, 70 cents on the dollar.

KUDLOW: No, no, that part I agree with.

Mr. PAULSON: OK.

KUDLOW: It's got to be consistent and transparent.

Mr. PAULSON: Now, I do agree that, in the middle of a crisis, where  
there is  
no liquidity...

KUDLOW: Right.

Mr. PAULSON: ...OK, where there is no liquidity, that mark to market  
accounting could be an accelerator.

KUDLOW: Ah. It's a small concession.

Mr. PAULSON: But...

KUDLOW: My first concession from you this evening.

Mr. PAULSON: But there is no system that is perfect.

KUDLOW: Yeah.

Mr. PAULSON: And I believe that with mark to market accounting, we would not—we would've been less likely to get to the problem to begin with.

KUDLOW: Right.

Mr. PAULSON: Recognize losses or...

KUDLOW: One other one, before the break. One—I don't mean to be abrupt, but so many things to talk about.

Mr. PAULSON: Yeah, yeah.

KUDLOW: I need you for three hours, but only have you for this hour. Fannie and Freddie taken over by the government into so-called "conservatorships."

Mr. PAULSON: Right.

KUDLOW: Then, bang, Lehman Brothers goes down into bankruptcy.

Mr. PAULSON: Right.

KUDLOW: Then, bang, AIG is essentially rescued or bailed out...

Mr. PAULSON: Right, right.

KUDLOW: ...whatever we're going to call it. A lot of people think that those conflicting signals of policy helped create the credit freeze-up. A lot of—you—with this, with this, with this.

Mr. PAULSON: Yeah.

KUDLOW: I'm going to wait till the next segment to talk to you about TARP and going from toxic asset buys to capital buys.

Mr. PAULSON: Right, right.

KUDLOW: But on this point, you saved Fannie and Freddie, "saved" is a relative term, but they didn't go under.

Mr. PAULSON: Right.

KUDLOW: Lehman went under, AIG was saved, and people said, 'Huh? We don't know who's next.'

Mr. PAULSON: Well, let me explain. First of all, I haven't heard the sane argument yet how stabilizing Fannie and Freddie led to the crisis. In other words, when the thing that I...

KUDLOW: Well, only in relation to letting Lehman go down, sir.

Mr. PAULSON: Well...

KUDLOW: That's what I'm saying.

Mr. PAULSON: Without...

KUDLOW: Mix—this is what you call mixed signals.

Mr. PAULSON: OK. I would—I would say this, with Fannie and Freddie, I viewed that as the most important step. There were \$5.4 trillion of securities out there.

KUDLOW: Mm-hmm.

Mr. PAULSON: That is huge. If those organizations had become really unstable or done down, we would've had an absolute disaster. So part of the story in the book is I tell—is a race to get that done.

KUDLOW: Mm-hmm.

Mr. PAULSON: Which was not easy before Lehman was announcing his earnings.

Now, I was naively hopeful for a short time that maybe that would be such a positive—it—for the world to know those were stable, it would've staved off the Lehman. Now, in terms of the mixed signals...

KUDLOW: You say—great. You think if the world knew that Fannie and Freddie were stable, that would've stopped the run on Lehman?

Mr. PAULSON: Yeah. I was hopeful.

KUDLOW: Work me through that.

Mr. PAULSON: Well, I was hopeful...

KUDLOW: I'm not sure I understand that one.

Mr. PAULSON: ...because what would...(unintelligible)...if you saw, when you look at \$5.4 trillion in securities held all over the world, if you find they're stable and the credit spreads shrink, that creates a value on everyone's balance sheet. They're no longer worried about will mortgage financing be available. I mean, that was a—that was—it's not stabilizing to know that Fannie and Freddie have come unglued.

KUDLOW: Right.

Mr. PAULSON: OK, but...

KUDLOW: May not be so stabilizing to know they're permanent wards of the state.

Mr. PAULSON: No, but I don't like—and they shouldn't be. The step we took was to be a time out and to show everyone the current structure wouldn't work, is greatly flawed, and needs to be changed.

KUDLOW: Well, nobody disagrees with you there. What I'm saying is there is this sort of...

Mr. PAULSON: Now, but listen, but now let's get to your...

KUDLOW: ...up and down policy thing.

Mr. PAULSON: Now let's get to your basic question. There was not—we did not have all the authorities we needed. So we raced—we worked with Congress and it got just in the nick of time, the authorities we need Fannie and Freddie from going down, OK? We had—Bear Stearns was quite interesting for us because with Bear Stearns, we had a buyer.

KUDLOW: Right.

Mr. PAULSON: The best buyer in the world because you had a...

KUDLOW: JP.

Mr. PAULSON: You had JPMorgan, strong credit, a CEO that was decisive and had the confidence of his board and so was able to do a deal. But going into that weekend, we knew that Bear Stearns had already started to unravel, the run had begun, and that if we didn't leave that first weekend with a deal with

JPMorgan where they agreed to guarantee the trading book, during dependency of the shareholder vote, this company was going to disintegrate. So what we learned that weekend, we knew it theoretically beforehand, but what we learned the weekend was when you have someone that's an investment bank with a capital and a liquidity issue, that we didn't have the authorities to deal with it in government. And so, at that time, we didn't—and...

KUDLOW: But to the rest of the world watching this, including all these big financial institutions and hedge funds and private equity funds we're putting liquidity in and taking liquidity out of the market...

Mr. PAULSON: Yeah.

KUDLOW: ...would it have been better after you completed the Bear Stearns action, which was March of 2008, to lay down a clear policy line about who's going to win and who's going to lose and how?

Mr. PAULSON: Well...

KUDLOW: Would that have been better to do that?

Mr. PAULSON: ...I don't know...

KUDLOW: Because it got very ad hoc in September, October.

Mr. PAULSON: Well, we were doing—let me say this. I look at it—we were doing this until we got there with TARP, we were—we were—we were late all the way along, as we tried to put out the fire, but the policy line, we didn't change policies. The facts changed. So, for instance, we did everything we could to save Bear Stearns. We stabilized Fannie and Freddie, put them into conservatorship, and with Lehman, we would have loved to have done—been able to present—prevent that failure. But in Lehman, you didn't have a buyer to fill the capital hole.

KUDLOW: I understand.

Mr. PAULSON: ...OK.

KUDLOW: I'm not criticizing the Lehman decision.

Mr. PAULSON: So I'm...

KUDLOW: I'm just saying it was like some were up, some won and some lost.

Mr. PAULSON: See, the perception, there was only one that—where we were unable to save and that was Lehman.

KUDLOW: All right.

Mr. PAULSON: And what—so the inconsistency and what people miss, there were—there were two issues with Lehman, OK? We didn't have a buyer to fill the capital hole and guarantee the trading book during...

KUDLOW: I understand.

Mr. PAULSON: ...which—and the Fed didn't have the power to do that.

KUDLOW: And the British regulators wouldn't sign off on it.

Mr. PAULSON: And we—and—yeah. So we didn't have that, number one. And then number two, if there had been someone, there still would've been a challenge, given the size of the capital hole, for the Fed to make the same loan it made for Bear Stearns, that would be secure to the satisfaction.

KUDLOW: I understand.

Mr. PAULSON: Because—but that's—but that's one of the things that worked with the private sector.

KUDLOW: All right. We can take break. We're going to come back. I want to talk about the AIG bailout. I want to talk about trading partners with AIG such as Goldman Sachs. I want to talk about the populist revolt against TARP and bailout nation. And we're going to talk about some of the individuals that Mr. Paulson dealt with, including Barack Obama and John McCain and, of course, President George W. Bush during this fateful period. Staring down the abyss, I agree with that. The question is, did we get it right? Stay with us. We'll be right back. I'm Larry Kudlow.

(Announcements)

Announcer: Live from Washington with former Treasury Secretary Henry Paulson, a special edition of THE KUDLOW REPORT.

KUDLOW: All right, welcome back, everybody. I'm live with former

Treasury man Hank Paulson. He was at the very center of the financial crisis, writes about it in great detail in his brand-new excellent book called "On the Brink." Out today, rising up the Amazon.com list.

All right. TARP is a hated word politically. Bailouts, hated politically. Populism from the left and the right. And AIG, a three letter dirty word, hated politically. I'd like to zero in on that. First of all, what can you tell us?

Mr. PAULSON: Well, let me start with TARP being hated; and, in some ways, I think it's good because we, as a country, don't like bailouts.

KUDLOW: Ah.

Mr. PAULSON: And the president said it in the State of the Union.

KUDLOW: Right.

Mr. PAULSON: He said Republicans, Democrats, all of us. And you know, I hate it. I hated the things I had to do. It was just much better than the alternative, which was Armageddon, as you said. And the—I remember looking at a poll once and—which put it all in perspective for me. I said—it said 93 percent of the people in the US were against the bailouts. I was trying to figure out who the other 7 percent were. And it said—but 60 percent were against torture.

KUDLOW: Ah.

Mr. PAULSON: So that put it—that put it all in perspective. And the...

KUDLOW: But Rasmussen says, if you pay down your TARP bill, Rasmussen's poll show, then people say you're OK as a bank.

Mr. PAULSON: Well, I would say this, I believe that we're going to get—you know, we designed these programs so—to maximize the likelihood we get it all back. We're going to get everything we put back in the banks with a nice profit. And I think—although we've got to look at it over a five-year horizon, I think people are going to be surprised on the upside...

KUDLOW: Mm-hmm.

Mr. PAULSON: ...in terms of getting the—getting either all of it back or most of it back and—if you look at everything, and that includes some of the money for the—for actual spending programs as opposed to investment

programs.

KUDLOW: Were you aware of this AIG brouhaha—it's like the story that refuses to die. All right, we bailed out AIG, but then comes the second wave of the story, that the AIG trading partners were bailed out 100 cents on the dollar, including your old firm Goldman Sachs. And this has created another furor, and it's created a furor around Tim Geithner. Were you aware that the New York Fed was trying to prevent full disclosure on the amount that the Goldman Sachs type trading partners got in the AIG bailout? Had you heard anything about that?

Mr. PAULSON: Larry, I had heard absolutely nothing about it, but—well, when I say that, which is I had heard nothing about it, the—I want to...

KUDLOW: On the secrecy, the nondisclosure.

Mr. PAULSON: Oh, absolutely. And I had had not only had I heard nothing about disclosure, but I had no involvement in the decisions related to how to deal with the counterparties and how to pay them.

KUDLOW: The 100 cents on the dollar payout.

Mr. PAULSON: Right.

KUDLOW: You were not—that was not—you were not part of that decision?

Mr. PAULSON: Not at all.

KUDLOW: You were in the center of every decision at the time.

Mr. PAULSON: But I want to come back, first of all, because I want to just say how strongly how much I support the Fed's action, how necessary it was and...

KUDLOW: For secrecy over this...

Mr. PAULSON: No.

KUDLOW: ...for this cover-up?

Mr. PAULSON: In terms of bailing—in terms of the rescue of AIG.

KUDLOW: Oh.

Mr. PAULSON: And that loan, and I'll tell you the thing that I—the other thing I just feel very strongly about is having worked with the people I worked with there and knowing what their motives were.

KUDLOW: At the New York Fed.

Mr. PAULSON: At the New York Fed.

KUDLOW: But they made a huge blunder, Hank.

Mr. PAULSON: Well, I...

KUDLOW: They never should've allowed this secrecy cover-up thing to get out of the bag.

Mr. PAULSON: I will say this. I'm for transparency.

KUDLOW: Right.

Mr. PAULSON: But I will say this, I know these people, I know what their motives are, I know how hard they are working to save the system. I know their professionalism, I know their integrity, so I am not going to second guess. I will be the last person to second guess what they did.

KUDLOW: All right. But you are second guessing the decision to pay Goldman Sachs and others 100 cents on the dollar.

Mr. PAULSON: Of course. I'm not...

KUDLOW: And then what kind of trouble would Goldman had been in if they hadn't received that?

Mr. PAULSON: Look...

KUDLOW: This is one of the key issues here. Have we—did we rescue Goldman through the back door?

Mr. PAULSON: I would say very clearly that when we—when we—when AIG was rescued, that AIG was rescued to prevent a meltdown of the system, that this company, if it had gone down, would've taken everyone down. And as I look at it and when I've said I can just tell you what I'm—I believe in the very strongest way that was the Fed's motive, that was all of our motives at the time the loan was made, that the last thing on my mind was any

counterparty's  
exposure or claim.

KUDLOW: All right.

Mr. PAULSON: I knew—counterparties...

KUDLOW: Who the heck did then? Who did that?

Mr. PAULSON: I do. It was—the—once the loan was made, OK, once the  
loan  
was made, it was the Fed's job to...

KUDLOW: Mm.

Mr. PAULSON: ...to administer the loan. We were—we were all very  
busy. I  
was very busy doing other things.

KUDLOW: I understand that. The world was going to hell in a  
handbasket.

Mr. PAULSON: And I—but I mean, I got to...

KUDLOW: But this stuff comes back at you down the road.

Mr. PAULSON: But I got to tell you something, there was an awful lot  
going  
on; and, again, what the Fed did, I will never second guess. And, in terms  
of  
the decisions they made, I'm totally confident, knowing them, they  
made—any  
decision they made in the best interest of this—of this system and the  
country.

KUDLOW: All right, strong support. I still think the Fed made a big  
mistake  
on this, but whatever.

We're going to come back with Hank Paulson. I want to talk about  
President  
George W. Bush's role. I want to talk about John McCain and Barack  
Obama,  
two people that Mr. Paulson had a lot to do with in the late fall of 2008.  
And then, yeah, we're going to talk about Tim Geithner. He's the  
Treasury man  
everyone loves to hate, but maybe Geithner has better stuff than we  
know  
about. We'll be right back. I'm Larry Kudlow.

(Announcements)

Announcer: Live from Washington with former Treasury Secretary  
Henry Paulson,  
a special edition of THE KUDLOW REPORT.

KUDLOW: All right, welcome back. We're talking about Hank Paulson's  
new  
book, "On the Brink." It's a terrific read. Really the first and only inside  
government account; I call it straight from the horse's mouth. During  
this  
fateful period, the Armageddon period—by the way, I agree with you, we  
were  
looking into the abyss. I don't doubt that. That's your basic narrative. I  
think you're right. On the other hand, you spent a lot of time with—on  
the  
phone with Barack Obama and John McCain. My reading of these, you  
felt that  
Obama was much more measured and helpful, and you did not think  
that way about  
Mr. McCain.

Mr. PAULSON: Larry, there was no doubt that I had easier conversations  
with,  
you know, Senator Obama at the time than with Senator McCain. But  
both men  
supported the TARP legislation ultimately.

KUDLOW: In the end.

Mr. PAULSON: And both supported the—neither came out against the  
rescues;  
and, as I look back on that, and as I looked at it in the time, I've always  
been very grateful for John McCain for taking that position. Because, as  
he  
fell behind in the polls, it would've been very easy to play the populist  
card, and if he had we would've been defenseless and we'd have 25  
percent...

KUDLOW: But reading...

Mr. PAULSON: ...unemployment.

KUDLOW: I...

Mr. PAULSON: And so as I look at it, it was a—you know, it was—we  
were  
very fortunate, and—because the crisis came at the very worst time,  
because  
it came six weeks before an election.

KUDLOW: Right.

Mr. PAULSON: And so everyone, at the Hill, both candidates, they've got  
to  
go through this with one eye on the polls, and, of course, anything that  
even  
looked—would've smacked of a bailout is—was going to be very  
unpopular  
because, you know, in our system, if a—risk takers are supposed to bear

the responsibility for their losses, no one—the idea of having public assistance for any institution, let alone a bank with private profit is, and it should be, an anathema.

KUDLOW: I understand. I understand.

Mr. PAULSON: And so this was going on.

KUDLOW: I got to go to lightning. I got to go lightning. You're too good. No, you're too good for—you're just too good.

Mr. PAULSON: OK.

KUDLOW: I got to go to George W. Bush.

Mr. PAULSON: Right.

KUDLOW: You speak highly of Bush. Now, one of Bush's speechwriters wrote a book and said he was completely disengaged in the financial bailout, that you made all the decisions. In your book, you repeatedly are briefing him on the phone or in person, and he has to sign off on your major decisions, half of which, on the bailout stuff, he didn't want to sign off on, but he did because he felt it was for the good of the country. Am I giving an accurate reading?

Mr. PAULSON: You're giving an accurate reading, and I'll tell you, it's a very accurate reading, because we had—I didn't keep notes—I've got a good memory—and a lot of people do. There were—there were—there were good notes—notes in the White House, and good records. And the—and I would say that it was—from day one...

KUDLOW: Mm-hmm.

Mr. PAULSON: ...this is a man who was very engaged. We spoke frequently. Every major decision was reviewed with him. He understood the politics and the markets when this collision—in the book, as I said, is a collision between markets and politics.

KUDLOW: Mm-hmm.

Mr. PAULSON: And he was the one that always said, 'This may not always look good. This is going to be ugly.'

KUDLOW: Right.

Mr. PAULSON: 'We're going to have to hold our nose,' or what have you, 'but we are not going to let a lack of doing the right thing here hurt the American people and the economy.'

KUDLOW: I got to hard out. He said, real quick, real quick, one word answer. He said, 'In order to save the free market system we have to suspend it.' Do you agree with that?

Mr. PAULSON: Yeah.

KUDLOW: All right, we're going to leave it there.

Mr. PAULSON: Yeah. Yeah.

KUDLOW: Hang on. Much more coming with Secretary Hank Paulson. I'm going to talk about some more political figures—Nancy Pelosi, Tim Geithner—and also spiritual guidance during the darkest period of the night.

(Announcements)

Announcer: Live from Washington with former Treasury Secretary Henry Paulson, a special edition of THE KUDLOW REPORT.

KUDLOW: All right, we've got a brief lightning round left with Hank Paulson, former Treasury man, on his book, "On the Brink," a very good read. Just one thing I want to get out of the way. A lot of people took umbrage when you, quote, "bowed down" to House Speaker Nancy Pelosi. In your book, you do suggest she wasn't all that helpful to your process of getting TARP through, but can you give us a quick comment?

Mr. PAULSON: Well, no, I thought she was helpful, and I thought it was pretty clear she was. You know, the—I needed to work with the—with the leaders on the Hill, and if Nancy hadn't been as supportive as she was, we never would've got it through. And I tell the story in the book of that night, September 27th, a Saturday, when we negotiated it. And I think she just all the way along, but there she played a key role in bringing people together and getting it done and said the American people expect this.

KUDLOW: Was it because you kissed her hand, or just she wanted to do it for the good of America?

Mr. PAULSON: Well, she wanted to do it for the good of America.

KUDLOW: No, I—say no more.

Mr. PAULSON: She—the leaders do...

KUDLOW: Say no more.

Mr. PAULSON: The leadership. But I'll tell you, it's...

KUDLOW: No! Say no more. I got to ask you this.

Mr. PAULSON: OK.

KUDLOW: I don't want to get out.

Mr. PAULSON: OK.

KUDLOW: Because I'm a spiritual person and so are you, and so are our wives.

You sought spiritual guidance during the worst part of this.

Mr. PAULSON: Yes.

KUDLOW: Tell me about that.

Mr. PAULSON: Well, I—prayer is an important part of my life, and I continually prayed for humility and, you know, strength, stamina, wisdom...

KUDLOW: We don't know everything, do we? We just, as humans, we don't...

Mr. PAULSON: ...judge...

KUDLOW: ...we don't know everything.

Mr. PAULSON: ...judgment. Yes. And it was—it was—it was very important.

KUDLOW: And your wife read scripture to you at one point on the phone?

Mr. PAULSON: Oh, yes, yes, that was—one day—she read scripture to me at more than one point.

KUDLOW: Did it work? Did it work for you in the next meeting?

Mr. PAULSON: It sure helped, because it was—I—it was a verse that was very

meaningful to both of us in dealing with fear.

KUDLOW: Boy, there's a lesson. There is a lesson for all of us in and out of government, a little scripture will help.

That's it. We're going to run out of time. Many thanks to former Secretary Treasury Hank Paulson. It's a hell of a book. I want everybody to go and join us, "On the Brink." And there was a brink, folks, and he has written a brilliant account.

Coming up, my last thought.

(Announcements)

KUDLOW: There can be little doubt that Hank Paulson's basic narrative that we were totally on the edge, on the brink, on the abyss was the key point. That's why you should all buy the book, "On the Brink."

I'm Larry Kudlow. See you tomorrow night. 🇺🇸

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