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# Hank Paulson's Countdown to Armageddon

## How the Chicken Little treasurer is nationalizing the U.S. economy

Tim Cavanaugh | September 25, 2008

"It pains me tremendously to have the American taxpayer be put in this position, but it's better than the alternative," Treasury Secretary Henry Paulson croaked Sunday, in the middle of a failed goodwill tour for his proposed $700 billion bailout package.

While Paulson's rhetoric of disaster has become more strident lately, he's been warning about the grim alternative to various government bailouts for nearly a year now. Lately, the pace has become tiresomely frenetic. Every Sunday, Dr. Paulson performs a few more unnecessary surgeries, warning that more procedures are needed. Every Monday the patient fails to die, and the doctor orders a new round of treatments, with a grim admonition that this round of incisions and laughing gas is preferable to the alternative.

But when Plan A is the de facto nationalization of the U.S. economy, it's fair to ask, just how bad would these alternatives be? Where are the soaring crime rates that are supposed to accompany an economic shock of the sort Paulson believes he is cushioning? Why are real estate values gradually coasting from exospheric back to merely stratospheric levels, when Paulson's nightmare vision should have them plummeting to earth? How are mortgage rates still hovering around 6 percent and business being conducted as usual, while unemployment spikes have been contained, as we would expect, to those areas of the country where the preceding boom was the strongest? Where are all these hypothetical retirees with depleted 401(k)s (and what could they have been doing so wrong all this time, given that even factoring in recent market turmoil, the Dow has nearly quadrupled since the beginning of the 1990s)?

Bluntly, why should any of us out here on what my friends in the mainstream media call "Main Street" give a rat's ass about the declines of Bear Stearns, Lehman Brothers, Morgan Stanley, Merrill Lynch, and Paulson's old kingdom, Goldman Sachs?

Just what is the catastrophe my great grandchildren will be paying $700 billion to avert?

It seems like a simple enough question. In a moment of unintended wit, *Wall Street Journal* spokesman Robert H. Christie recently told *The New York Times*, "'Crash,' 'panic,' 'pandemonium,' 'apocalypse,' those are the words we're staying away from."

So what words should we be using?

I've been trying to get this answer since late last year, when Paulson first began to panic. The closest I came was during a group question and answer session with the Treasurer in December. Some excerpts:

> Jon Healey: Many of the people we speak with don't like this because they see the results of the government's work being sustaining housing values that should have been allowed to come down.
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> Henry Paulson: Again, I've given my answer to that. I think what we're doing is avoiding a market failure that would have forced housing values down in a way that was not in the investors' interest, and in a way that the market wasn't intended to work.
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> Tim Cavanaugh: How can you force values down? Why aren't values finding their natural level?
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> Henry Paulson: The way values would go down is, as I've said, you'd have market failure...
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> Henry Paulson: ...What this will do will make a difference in that we won't have housing prices driven down in ways that distort the market because the industry wasn't able to come up with procedures to deal with an unprecedented situation.
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> Tim Cavanaugh: Is it distortion in the market when the market was already distorted up to a degree that maybe wasn't unprecedented, but was certainly unusual in American history?
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> Henry Paulson: So you'd like to see it distorted down too...
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> Peter Hong: Could you be a little clearer on what you mean by "market failure"?
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> Henry Paulson: As I've said, chaos...when I say market failure I say that we have an unprecedented situation, and the private sector has to find a way to deal with that. Otherwise you're going to see them drowning in people who can't make resets, whom they would ordinarily want to keep in a home.
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> Peter Hong: You used the phrase "distort down." Is it distortion or is it a correction?

> Henry Paulson: What I want is markets to work. And I would define a market failure as the system not being able to cope with the wave, so that foreclosures took place that would not have taken place if there were smaller volume...
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> Peter Hong: But are house prices too high?
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> Henry Paulson: I'm not going to—foreclosures are bad for neighborhoods. You have needless foreclosures that are driving down prices, created by a situation that is unprecedented and that would under normal circumstances not have taken place.

Even through the combative tone, the finely calibrated inanity of Paulson's comments remains a thing of beauty. It's a healthy market when prices go up, regardless of the potential value of the asset. It's a market failure when prices go down, even though they're going down specifically because we now know the asset was overvalued. (For the record, there's no mystery about the "normal circumstances" under which a foreclosure doesn't take place: If you pay your mortgage you don't get foreclosed; lenders who don't make an effort to ensure that you're a good credit risk run into problems. It's exactly that complicated.)

The secretary of the treasury isn't the only one trafficking in gnostic references to the pandemeltdownonalypse. In early 2007, as substantial numbers of subprime mortgage borrowers began failing to pay their obligations, a fanciful new language of contagion and epidemic sprouted up in the media. The crisis, so the narrative went, would spread to all levels of the economy unless it were quarantined through various governmental exertions.

This is a neat trick. Rather than the downturn's being the result of a series of bad decisions made by people who are now being punished, it's a force that threatens to engulf us all. We the American people may say the hell with mortgage deadbeats and the chumps who bought their loans, but that just shows why we need technocrats to show us the approaching storm. Hell, even Goldman Sachs is going down over this!

The storm, if it were allowed to arrive, would almost certainly be less dire than what Paulson and Federal Reserve Chairman Ben Bernanke have promised. Interest rates would increase (or no, wait, they'd soar!); business would slow down (I mean, it would crash); house prices would decrease (or maybe they'd careen); it would become harder to get a loan; the dollar would strengthen (something Bernanke, steeped in Depression studies, would not want). Then some time would pass and the economy would start to grow again. And credit would be provided by a newer and presumably wiser roster of banks. The mortgage downturn, like so many downturns, brings us back to the Foundation question: Isn't it better to let the empire collapse as quickly as possible, then move on to the next empire? Would anybody really miss Wall Street?

Christopher Thornberg, a principle economist at Beacon Economics and an opponent of the bailout, tries to understand the motivation for the rescue. "There are two kinds of financial stress," he says. "One is simple bad investments. The other is a panic and a run on the banks. But I don't understand why they think that's going to happen. And I don't see why the taxpayer has to be on the hook for a completely out of control Wall Street... The picture Bernanke's going to paint is: bank run after bank run. But there's no reason for banks to fail as long as the Fed is there as a backstop. That's the point of the Fed: to prevent bank failure by being a lender of last resort."

It's never been more clear what an orphan the free market argument is. The Republicans are looking to establish a form of crony socialism and the best the Democrats can come up with is to demand that the government establish CEO salary caps. And since everybody else sees an epidemic spreading, I'll see one too: Why should we stop at financial services? After this bailout, what will be the argument against having the government rescue health care, water and electric, airlines, print media, and other troubled industries?

The bright spot in the bailout argument is that the public—as it does with so much of what the government provides these days—seems to be spurning the offer. But if one pattern has become well established in 2008 economics, it's that nobody who matters cares what the public wants. In an apparently ironic statement on the bailout package, Matt Yglesias predicted that "everyone's going to have to give serious consideration to becoming a pretty hard-core libertarian." It may be more accurate to say we should all end up becoming financial Muslims, because if this is where lending at interest gets us, we'd be better off with no economy at all.

Actually, forget that last statement: I don't want to give Hank Paulson any more ideas.

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