



After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead

Public Affairs

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Introduction

JOANNE MYERS: Good morning. I'm Joanne Myers, director of Public Affairs Programs, and on behalf of the Carnegie Council, I would like to thank you all for joining us.

It gives me great pleasure to welcome Alan Blinder to the Carnegie Council. Today he is here to speak about his recently published book entitled *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*, which, by the way, has been receiving wonderful reviews. Congratulations to you.

In our attempt to understand what went wrong during the recent [financial unrest](#), there has been an outpouring of books on this topic. Even so, Professor Blinder writes that many of us still don't know why the U.S. financial system experienced such a perfect storm. Questions linger about what the government did or did not do to mitigate the effects and what motivated the responses that were made. For example, many think that the feds gave money away when, in fact, for the most part, they lent it.

After the Music Stopped addresses these gaps in our understanding by engagingly telling the story of the financial crisis, beginning with the events that led up to it, the crisis itself, and the [Bush](#) and [Obama administrations'](#) responses. It is less of a whodunit and more of a why-did-they-do-it. For these reasons, as well as others, you will find it to be quite different from earlier books on this subject.

Unlike many who write about Wall Street, Professor Blinder's real-world experience as former vice chairman of the Federal Reserve and member of President [Clinton's](#) Council of Economic Advisors provides a regulator's sense of what makes the various government agencies tick, as well as an intimate understanding of what the Fed was up against. In essence, it is an analysis of how economics and politics interacted to create this enormous crisis.

As one of our leading experts on how the Fed operates, Professor Blinder is quite deft in explaining public policy and interpreting arcane financial dealings. You will find not only that he is pragmatic, but that his analysis of responses by policymakers provides invaluable insights.

Since the financial crisis began, America has been through quite a lot. As we begin 2013, it appears that the threat of recession has retreated, and there are some encouraging signs of an improving

economic outlook. Yet economists warn that the economy remains fragile. And as if that's not enough, partisan politics could make it even worse.

Alan Blinder is someone who can help us understand not only what sent the U.S. economy into a tailspin, but what we have to do to reduce the likelihood of a similar event in the future.

Please join me in giving a very warm welcome to our very distinguished guest. Professor Blinder, thank you for joining us.

Remarks

ALAN BLINDER: Thank you very much. I appreciate being here.

Let me start with the question that I'm told an author should always start with: Why did I write this book? You just heard half the answer, actually, from Joanne. But what I want to do is, without naming him, I want to read an email to you that came from a gentleman who had just started reading the book—a perfect stranger. I don't know him; he doesn't know me. This is why I wrote the book.

He says, "I'd like to start off by saying thank you. I thank you for being the one who wrote a comprehensible book on the financial crisis. I also want to thank you because I've been waiting for the past few years for a book like this to be released."

Now the best sentence: "I'm only on page 9" —[Laughter]—"but I already have a clear picture as to how this fiasco began. My wife was on the train with me this morning and she even began to read it with me. I do hope more people pick up your book. I'll help spread the word," and so on.

I wrote back to this gentleman. I said, "Thank you very much. You're exactly the person that I wrote this book for."

Maybe I should start with the only quotation from the book that I'm going to read today. I think it's putrid for people to just quote themselves. But the first sentence of the book says, "Did anybody get the license plate of that truck?"

I think American society feels that it got flattened by some mysterious truck that came careening down the road, driven by a reckless driver—it was a hit-and-run—who then kept on driving and wasn't punished for his or her—though, frankly, they were mostly "his," I must say—transgressions.

They know that they are unhappy. They know that the economy has been behaving poorly. Millions of them have lost their jobs. Millions have lost their homes. Virtually everybody has lost some wealth. Anyone who had any wealth has lost some wealth as a result of that. And there's a minimal understanding about why.

The other reason is that I was trying to—I held back in writing. I'm standing in a wonderful nonprofit. Here's the proof that I wasn't maximizing profits in doing this. Several publishers came to me early on in 2009 and said, "Could you write a book about this crisis?"

I said, "No. I don't know where this is ending. I don't know what acts III and IV are going to look like. We've only played out acts I and II, and I can't write a book."

I would have sold a lot more if the book had come out in 2009, and a number of journalists wrote some very nice books. Some of you may have read them. I've read quite a few of them and learned from them.

But this is not a book of journalism, first of all. This book is not one where you find stories about how so-and-so was in the middle of eating a pepperoni pizza when his cell phone went off and the company was going under. Those make good reads. I'm not criticizing it. But that's not what this book is about.

It's also meant to be holistic. One of the reasons people don't understand this is that this was multifaceted. Things were coming at us from all over the place. There were fiscal things; there were Federal Reserve things; there were these mysterious derivatives; there were international ramifications. I tried to tell the whole story. That's why it's kind of a thick book.

The other small anecdote: One publisher that was somewhat interested in the book got turned off. She said to me, "You have to cut this to 250 pages." I said, "I can't do that," and I went with a different publisher. It's not a 250-page story, unfortunately. It's a very messy, big story.

As Joanne said in the introduction, there is tremendous misunderstanding of what has happened in the policy regime. The most outstanding example of that is the [TARP](#), the Troubled Assets Relief Program. It is now a polite curse word in Washington to say, "That's like the TARP." If you say, "That's like the TARP," the proposed legislation is dead, completely dead.

People think that the United States government spent \$700 billion on shoveling money into the pockets of undeserving bankers and getting nothing in return. The only thing that's true about that sentence is the adjective "undeserving." They were undeserving. Lending the money to the banks was a necessary ingredient in stopping the ship from sinking. If the ship had sunk—and we came pretty close—most all of us were going down the ship.

I like to make the analogy to collateral damage in a war. You fight a war and some buildings get knocked over, and some people get killed, and they had no part in this, and it shouldn't have happened. But when you're fighting a war like that, messy things happen.

The money that went to the banks was collateral damage in a total war against financial collapse. And importantly—but not understood by the American taxpayers—the taxpayers got all their money back, plus interest and capital gains on the options that they bought. You know the old [Adam Smith](#) adage: Buy low, sell high. That's what the TARP did. It bought low, sold high.

By the way, that's what the Federal Reserve did as it acquired trillions of assets. It bought low. It hasn't sold yet. But it's holding in its portfolio nothing but appreciated assets.

In fact, here's a little fun fact for you. I actually haven't checked this in this last week, but I don't see that there would be any change. Not only has the Federal Reserve made a paper profit on all these assets that it has acquired to fight the crisis and try to spur the economy, but in its portfolio, as of the last time I inquired, there was not one single loser. Imagine that. Think about your own portfolio. I don't even want to think about mine. I've got lots of losers. I've got some winners, too. That's what most portfolios are like. The Fed's portfolio has no losers in it—not a single issue.

You're thinking, what about Bear Stearns? No. Most of the Bear Stearns assets have been sold by now by the Fed at a handy profit. No losers at all in the Fed's portfolio, and hence no cost to the taxpayer.

But because of the misconceptions, I fear very much what might happen if we had another financial conflagration anytime in the next one year, two years, dot, dot, dot, until people forget. And that will take a while, I think.

I know there are a number of UN ambassadors in the audience. As you all know, it wasn't so very long ago that we in America, not to mention people in Europe much more so, were worried about an implosion in the [euro zone](#). That now seems remote. It's not about to happen. But people were talking about a Lehman II scenario, as you may recall, six, eight months ago. Had that happened, I just have this fear that we would not have really fought back very hard, because there was no way, for example, you would get another TARP through the U.S. Congress because of this myth of failure.

That's why I think the history needs to be rewritten. The history that has been written by some journalists—many are totally blameless on this, but some journalists, a lot of talking heads on television, and a lot of politicians—and it's just wrong. That doesn't mean the policy measures that were taken by the U.S. government and by the Federal Reserve were perfect. They weren't perfect, and there's plenty of criticism of them at the level of detail in this book. But by and large they were very, very effective, and it's potentially to our detriment if we read the history incorrectly.

The other thing I worry about, and all of you should worry about, too, is that the financial industry looks eager to get back to business as usual rather too quickly. You see this in a variety of ways. You see it in large-scale risk taking, after what should have been a very thorough and traumatic lesson in the crisis. You see it in the intense lobbying, much of it successful, against regulation, to weaken [Dodd-Frank](#) or even to not let it come into effect. You see it internationally in the postponement of the Basel standards recently on liquidity. The capital standards—if you don't get this jargon, don't worry about it; it's not important—the capital standards were written originally not to take effect until 2019 fully. 2019? It takes seven years for banks to get ready for this? Now the liquidity standards—this has to do with cash on hand—are also postponed until 2019.

So there's a sense in which the retrograde forces are winning out—not always, not entirely. That's again partly because of misreading of the history.

What you have in this book is:

- A beginning, which is an interpretive history of what's a pretty interesting story, but, as I say, a complicated story that I try to make as simple as possible. One of my all-time favorite quotations is [Einstein's](#) statement that everything should be made as simple as possible, but not more so. This is like the atom. There's an irreducible level of complexity in a story that is this complex. But it's as simple as possible.
- A lot of detail on the policy responses that I have just been alluding to.
- A tentative attempt to peer into the future.

We have an unfinished agenda because of the crisis. Some of it is regulatory, as I was just mentioning. Some of it is fiscal. We have a trillion dollar deficit. That can't be sustained indefinitely. We have to get that down. And we have a Federal Reserve that is in an extremely unusual position, both in terms of the interest rates that it's pushing on the economy—zero at the short end—and the size and composition of its balance sheet. The Federal Reserve came into this crisis with about \$900 billion in assets and it now has \$3 trillion. Chairman [Bernanke](#) and others on the Fed have said that they want to get back a lot closer to \$900 billion. It's a long way from \$3 trillion to, say, \$1 trillion, in round numbers. (We won't quibble about \$100 billion.)

The central message of the book, to me, is what I call the policy paradox that I have been alluding to before. You had a situation where the financial markets ran amok in a variety of respects, aided and abetted—or maybe I should say enabled—by light to nonexistent regulation, light in many of the

banks, nonexistent in most of what got to be called the shadow banking system, and in particular in the world of derivatives. Many of you know this. If you don't know this, you will find it unbelievable.

We passed a law in the year 2000 that basically said the government may not regulate derivatives. Think about that. It's one thing that you don't do it or you do it badly. We actually passed a law that says, "Here's a stop sign. The government may not go through it. That's the world of derivatives. You have no business there." It's quite amazing in retrospect.

So enabled by things like that, the financial systems ran amok, almost pulling the entire economy down with it, leading to approximately \$18 trillion of wealth destruction—trillion. The government then got the message too late, came running in, mostly after [Lehman](#) went under in September 2008, when things turned from bad to horrible, and started fighting this crisis in a variety of ways, as I said a few moments ago, pretty effectively—not perfectly, but pretty effectively—so that the worst case scenarios didn't come close to coming true.

In the winter of 2008-09, there was a lot of talk about [Great Depression 2.0](#) and that the GDP was going to be shrinking for the next two years and it was going to fall whatever percent—much more than it actually did fall—and so on.

None of that came true. Much of the reason it didn't come true was the government's interventions of various sorts, of which I can name a couple.

Yet at the end of this there was an anti-government backlash, exemplified by the [2010 elections](#) and the rise of the [Tea Party](#). What's the central message of the Tea Party? You remember that famous quote in the summer of 2009, not long after this crisis finally abated: "Keep your government hands off my Medicare." Remember that? It's an interesting thought.

But if there was any central thought to the Tea Party, it was that the government is too big, too intrusive, and get out of my backyard. That's the reaction we had to the government coming in and saving the day.

This series of events was kind of bookended by that at the end, the 2010 elections, when many of the people that had voted for the TARP either had a very difficult time defending their seats if they were in a safe district or got turned out, and the country turned dramatically towards the right in its vote. That was the end of it.

The beginning, the first bookend, was a wonderful cartoon—probably a lot of you saw it at the time, but if you remember it, you have a better memory than I do—in, I think, March of 2009. This was the height of the crisis, just about when the Dow Jones industrial average hit its bottom. *The New Yorker* published a cartoon which showed a medieval courtyard. The king—it was a king because of his crown; that was a dead giveaway—was leaning over on the stump of a tree and the executioner is like this, and a page runs in and says, "Wait, stop. The government's part of the solution, not part of the problem."

This is the way we felt, or at least some people felt, during the crisis, while the storm was crashing over our heads. But as soon as things got better, already by the summer of 2009, you started getting this Tea Party ferment leading to the 2010 elections. This is the paradox to me, and it's a worrisome paradox.

Let me just take a few more minutes briefly listing, rather than delving into detail, some of what I think are the reasons behind this paradox, several of which are obvious.

The most obvious is that we endured a terrible slump. The economy turned out badly. It doesn't do a lot of good to say, well, badly, but not nearly as badly as it would have been.

There's a wonderful quotation from [Barney Frank](#), which I'll paraphrase because I can't remember the exact words. He basically said that you may be able to get tenure at a university by saying, "It would have been much worse without me," but you can't get elected on that basis. The voters just don't go for the notion, "It would have been much worse if our opponents were in charge," and they didn't go for it.

Secondly, and related, this crisis had approximately 315 million innocent victims. That's just in the United States. It had at least that many abroad as well. But 315 million people thought they were innocent victims, and they were mostly right. If you think about how many miscreants there were—nobody really has a count on the miscreants, but could it have been more than a few thousand? I don't think so, in a country of 315 million. So we had—I'm making up a number—2,000 guilty parties and 315 million innocent victims, very unhappy.

Among those 2,000—again, a number I just made up to focus the mind—how many went to jail? Almost zero. Zero is a good estimate. I think the right answer is four or something like that. That doesn't seem right. Only now is the United States government starting to get serious about prosecuting fraud from that. It's a mystery to me why we let so much time go by. I want to be clear, fraud is a high bar. It implies intent. It's criminal. It's a higher standard of proof than a civil suit, as it should be. It's not like everybody who did something stupid did something fraudulent. Nonetheless, I can't believe that only three or four or five people committed fraud in this episode.

Fourth, a central piece of the rescue operation was the "bank bailout" that I alluded to before. No government in history has ever been able to, and I don't think any government in history ever will be able to, make a bank bailout politically popular. Come on, that's like saying, "I love skunks," or something, or that the skunk should be the national emblem. You cannot make a bank bailout popular.

I don't think the Obama administration did as good a job as they could have in selling and explaining what they did and why, especially why they did it. But all that said, if they were perfect on communications, which they were not, it still would have been unpopular. You can't make a bank bailout popular.

But, as I said—this is the fifth thing on my list—they did not do a very good job of communications. I'm a big supporter of President [Obama](#). I voted for him twice. I was very disappointed that a gentleman that looked in the [2008 campaign](#) to be a fabulous communicator, a Democratic [Ronald Reagan](#), just failed to communicate to the people what in the world was going on, why the government was doing the things it was doing, many of which were counterintuitive. That's something that's obviously counterintuitive to a lay person. The bankers did bad things and got in trouble. So what am I going to do? I'm going to give money to the bankers. That's very counterintuitive. That implies a very heavy burden of communication, if you are going to try to sell this to the voters, and the task was just shirked.

Sixth, and very much related to the Tea Party-ish attitude, the Federal Reserve, which many people in America had barely heard of before, all of a sudden is everywhere, buying this, rescuing that, not rescuing that, making gigantic loans. Federal Reserve lending went from approximately zero—I think the exact right number was \$200 billion (there's more wealth on this block than \$200 billion)—from \$200 billion to \$1.5 trillion—trillion—an unheard-of number. That's just the lending. Then there were

the assets.

A number of people on the political right apparently discovered to their great dismay that this institution in Washington, the Federal Reserve, has the power to create money. Wow, there's a revelation. Of course, that's what it was founded for in 1914. It has had that power since 1914, but I think a lot of people didn't know that.

Seventh, the deficit exploded, as you all know. Deficits have always been very unpopular at the lip service ideology level in the United States of America, as long as we have had public opinion polling, going back at least to the 1930s, if not before that. But I say at the lip service level because when the pollsters then did one level deeper and say, "Here's a list of things that could reduce the deficit. What do you think about them?" they all lose except foreign aid. If you read polling literally, Americans want to reduce the deficit by cutting back foreign aid. You know the analogy, it doesn't get you to first base? It doesn't actually get you out of the batter's box on the way to first base, if you zeroed out foreign aid. But that is what people want.

Finally, and most controversially—I have sort of cast my oar on this in the book, but many historians as we move through time will give subsequent evaluations—President Obama eschewed very explicitly, even though [Tim Geithner](#) was advising him otherwise, the notion of pegging his presidency on saving the economy from ruin, on, to use the [Bill Clinton](#) phrase, "focus like a laser beam on the economy."

He said, "I'm not doing that. It's not enough for me. I want to do many other things." And to his credit, he got through health-care reform and a variety of other things. It's amazing, actually, what was accomplished.

But I think that led the American electorate to look at what was coming out of the administration and just see a cloud of gases, like before the Big Bang or something like that. I don't see what one thing has to do with another. What is it that the president really wants to do? The answer "everything" is not really an answer. I think that hurt in terms of getting people to focus on what the administration was doing to fight the economic crisis and, more importantly, to understand and appreciate what was done.

So that's my little list of the factors that I think were behind the paradox of policy. The list is conjectural, but I think the fact that there was this paradox is not conjectural at all. It is palpable—and, by the way, I think is still affecting our national politics.

Thank you all for listening.

Questions

QUESTION: My name is Edward Marschner.

I was very, very gratified to hear you focus in on the lobbying effort being exerted, a very expensive effort by all those bankers that got money, to hobble the legislation for regulating what's going on. I've heard this from [David Swenson](#), the asset manager up at Yale. I haven't heard it much anywhere else. I think in the spirit of communicating to legislators and to other opinion leaders, you're doing a great service by putting a focus on that. Where do you go with it? What do you recommend be done at this point, rather than just hand-wringing?

ALAN BLINDER: In some sense, the biggest answer is something that I have no idea how to do,

which is, get the public refocused on this. I don't think that's impossible for a good political entrepreneur, because the polling still does show Americans are mad at the financial industry. They say "the bankers." A lot of it wasn't bankers, actually. But they are mad at the financial industry, and in the abstract—just as in the abstract they want the deficit smaller, in the abstract, they want more regulation of the financial industry. But it will take an act of political entrepreneurship to focus that anger in an effective way, and that's hardly my comparative advantage.

More concretely, the Dodd-Frank Act passed in June, I think, of 2010. It is still not promulgated. A few pieces of it are. Regulations are still being written. Enforcement mechanisms are barely off the drawing board. There is a lot of work to be done.

So part A is, stop hobbling the agencies by holding back their budgets. This is one of the things that has been done. The Security and Exchange Commission and the Commodity Futures Trading Commission were assigned huge responsibilities by Dodd-Frank. They didn't get any more budget, or not much more budget, to do this. This is not a problem for the Federal Reserve, which prints money. The Federal Reserve throws its money resources at this as it needs to, as it feels proper to do. And they are throwing a lot at it. But they're not the only ones. So that's one thing.

Secondly, in the American political system, the battle you have in Congress—and it was a whopper to get Dodd-Frank through, as you may remember—is only the first battle. Then you have all kinds of battles at the level of detailed regulations. The public is not paying attention, and the financial industry is in there with their vital interests at stake. They're having some significant effects.

My least favorite example of this is the regulation of derivatives. I mentioned that we had that awful law in 2000 that said none. That's gone. Dodd-Frank does provide for some regulation of derivatives. It's relatively mild regulation, but it's a lot more than we used to, and it's definitely a step in the right direction. Here's one of the many battles. Some of this is so complicated, I don't know if anybody understands it, but here's one that's not complicated, which I think is important.

A major thrust of the Dodd-Frank regulation is to push more derivatives than were previously standardized and traded on organized exchanges, as stock options have been for decades. That's a derivative. But these other financial derivatives that were involved in this crisis were not. They were, in the jargon term, traded over the counter. That means you called Big Company X and said, "I want this kind of a derivative with these terms on this date, this amount," and they would quote you a price. Now go try to comparison-shop that. It's customized.

If more derivatives are standardized and traded on organized exchanges like stock options are, they will be much, much safer. And Dodd-Frank goes some way to do that. But it leaves a lot in the unstandardized, customized world—more than it should, in my view.

The industry, of course, is trying to push the boundary in the other direction. The reason is very simple: That's where the money is. Think about what your stockbroker earns when you say, "I want to buy call options on Google at \$525 that expire in September," or whatever. The exchange gives you choices, and that's the one you pick. They make a nickel on the trade, whereas if you get on the phone with one of these big bankers for a customized derivative, they make a lot more than a nickel. And they're trying to defend their profitability. It's perfectly understandable.

We need a counterforce on the other side.

QUESTION: My name is George Paik.

First of all, thank you for this book. I'll echo your emailer, having read the reviews.

Now that you have, if you will, addressed this source of confusion, perhaps there's another body of confusion. In a sense, we're looking at a slightly different issue than a financial crisis now. It's economic confidence. What would be your comment on the idea that economic confidence was already—and I mean before the housing boom—a dependent, weak thing that was only sporadically revived by various booms and not fully natural occurrences?

ALAN BLINDER: I don't actually agree with that, going back in time, but I agree with it now. I think, in fact, contrary to what you said, there was excessive euphoria—Alan Greenspan would have called it irrational exuberance—prior to the bust. One effect of that is that households bought homes they couldn't afford with mortgages that had practically no money down—in many cases, literally no money down—and with teaser rates that were going to rise. The way they could actually stay in the house is if the house went up in value and in another two years they refinanced and took some cash out. It was that kind of thinking that enabled this housing bubble to grow to the size that it was. The unemployment rate got down to below 5 percent during the boom.

Since the travails of 2007, when it was only starting—mainly 2008, 2009—confidence has been completely shattered. It's starting to come back now, with ups and downs. A consequence of that is that banks don't want to lend. Many businesses don't want to borrow, even though, in order to grow, they need to borrow. But they're afraid to borrow. Households have been afraid to borrow—but not that much. It's surprising.

When people were saying at the depths of the crisis, "The real problem we're going to have is that Americans are going to start saving like mad. They will be too afraid to spend," I would say, "You know, these are Americans. We're not dealing with Italians or British. These are Americans, and one thing Americans do is spend money."

To make this concrete, there were some people, forecasters, who were saying the U.S. savings rate—this is kind of an inverse measure of confidence. It's the fraction of each dollar that you save, which had gone as low as about 2 percent in the couple of years before the crisis. That's way too low, by the way, but it was a measure of people saying—"let's just spend because things are great." They were forecasting that this was going to go to 8 to 10 percent. Had that happened, we would have had a depression. It's baked in the cake if that happened.

I never believed that would happen, and it didn't happen. It did go up to about 5 percent. Now it has backed off to about 3.5, 4 percent. It's still too low for the long run—higher than it was before the boom, but a much lower savings rate than the fears. So that's a measure in itself of confidence.

You hear a lot that it's the American consumer that's holding things back. That's really not true.

If you want to know arithmetically why the economy hasn't grown faster than it has over the last four years, there are two basic reasons:

One is housing, which was down in the cellar and not moving for a long time. Now it is moving, finally. This is 2013. It took quite a long time.

And—this may surprise a lot of you—the other reason is government spending. This made the headlines this morning. A big drop in government spending caused a zero growth rate in the economy, basically. But that was only an exaggerated aspect of what has been true since the stimulus started wearing off in 2010. Government spending has been on a downward track, not an

upward track.

It's not the consumer.

QUESTION: Ron Berenbeim.

In your canvas of the relief package in the wake of the big meltdown, you didn't talk about the mortgage relief package. You also just mentioned that housing has been a factor in the slower-than-anticipated recovery. Can you comment on that, please?

ALAN BLINDER: I'll be delighted to. I didn't mention this. I did mention that I had a lot of praise and some criticism for what the Obama administration did to fight the crisis. My biggest criticism is exactly to your point. It never did nearly enough to mitigate foreclosures—not that it did nothing. Let me step back one.

The TARP passed on the second try—you remember Congress turned it down the first time—in October 2008. If you read the TARP legislation—how many people here have read the TARP legislation? I have. It's quite long. Actually, the TARP part is only about 300 pages long, and then Congress lards—you know what Congress is like.

But to cut to the essence, the TARP was established with three purposes. It gave a \$700 billion kitty to the secretary of the Treasury—actually tranced out, so Paulson didn't get it all at once—for three purposes:

- Buy mortgages. That's exactly to your point.
- Buy securities related to mortgages. Those were these mortgage-backed securities and CDOs, and all this mess that was going very, very badly and nobody would buy.
- Third, "et cetera." The legislative language was something like: "Anything else the secretary of the Treasury deems necessary to enhance financial stability." That was a carte blanche—anything.

What did Secretary of the Treasury Hank Paulson do, among those three buckets? He put zero dollars into buying mortgages. He put zero dollars into buying troubled assets—Troubled Assets Relief Program; they got no relief. And he put all the money he had—much was left for Tim Geithner, when he became secretary of the Treasury—into infusing capital into banks, mostly by buying preferred stock and taking warrants and things like that.

Was that a dumb thing to do? No. The banks needed capital badly. The government, as I said, made a nice profit in the end on that. But it wasn't intended to make profit. It was necessary to keep the banks afloat, and therefore to keep all of us afloat. But what about the other two purposes? It's not that it was a bad idea to infuse capital into banks.

By the way, politically, it was disastrous. It made the whole thing look like a bait-and-switch. He came to the Congress saying, "We need all this money to buy troubled assets." Congress finally, reluctantly, gave him the money. He didn't buy one troubled asset. That doesn't really endear you to Congress.

It was a sensible thing to do, to put the capital in the banks, but it was not a sensible thing to do to ignore the others.

The Obama Administration comes in and they had one false start after another. Tim Geithner, early

in his tenure as secretary of the Treasury—and he was a very successful one, I might add—allocated \$50 billion of TARP money. Out of \$700 billion? Because of the complexity and the slow starts and the administrative difficulties, only a fraction of that \$50 billion was ever used to prevent foreclosures.

So you had a twofold, in my view, error by the Obama Administration: Not enough money was thrown at the problem. In 2008, as the foreclosure problem was blowing up, I, a Democrat, but also [Martin Feldstein](#), a Republican, and [Glenn Hubbard](#), a Republican, published plans in *The Wall Street Journal* that we thought would mean \$200 billion, \$300 billion to actually get your arms around this problem. We might have been way off. We were probably low, actually.

But \$50 billion? No serious person thought \$50 billion was enough, and only a fraction of the \$50 billion was ever used.

So the consequence of that is that we did not prevent as many as many foreclosures as we could have. We prevented some but we—"we," the government—did not prevent as many as we could have and should have.

Finally, just to put the capstone on it and relate it to where you were, think of yourself as a homebuilder. You like to build homes, but you like to make money when you build homes. You have these homes coming off foreclosure at half of construction cost, waves of them. How in the world can you build a new home and try to sell it for \$300,000 when people can buy it for \$150,000 after a foreclosure? It's no mystery, given the inadequacy of remedies to the foreclosure problem, why the housing market has taken so long to come back. It is only coming back very recently.

QUESTION: Allen Young.

You mentioned the unsustainability of the deficit. If you were philosopher king and could do whatever you want to do, what would you do to reduce the deficit?

ALAN BLINDER: Leave out the philosopher king. Make me the king and I can make the legislature do whatever I want. Here's exactly what I would do. I'm going to actually make it numerical, but you can move these numbers around. Even though I'm king, I'm not tied to the number.

I would like to see the Congress enact in the same bill—it would be a thick bill—a \$500 billion fiscal stimulus, probably over two years or a year-and-a-half, now, and a \$5 trillion 10-year deficit reduction program, so that, in the somewhat silly language they use in Washington, I would pay for it 10 times over. But the timing is crucial, that the stimulus comes first and the deficit reduction follows after, say with a two-year lag or something like that.

Furthermore, unlike the stimulus of 2009, which was okay in terms of its design—not great, but not terrible—I would focus my \$500 billion tightly on job creation. That is, I wouldn't use the philosophy—there's that word now—of the 2009 stimulus, which was "build it and they will come"—that is, make the GDP bigger and there will be more jobs. That's true, but if you do the math on the relationship of GDP to jobs, that ratio is about \$115,000 of GDP per job; a pretty expensive way to create jobs.

I would target this on job creation, including putting people straight on the public payroll, which, of course, the Tea Party isn't too keen on. But you invested in me the power of a king, and that's what I would do with it.

QUESTION: Bob James. I'm a businessman here.

I don't know what your book says, but largely today you say that the problem has been bankers and financial institutions, some of them fraudulent. Yet being in business and so on, I also find that the victims also had a lot of responsibility. The Fed had a lot of responsibility. Government spending certainly had been a problem.

Why banks and bankers?

ALAN BLINDER: Good question. First of all, in the book, in fact, I start, in terms of the culprits, with the old pogo line: We have met the enemy and it is us. It was American citizens—and not only Americans, Icelandic citizens, Irish citizens, Spanish citizens, and so on—that went hog-wild over housing and got themselves into some ridiculous contracts that they never should have signed. I absolutely agree with that.

Secondly, I did mention, though very briefly, that prior to the crisis there were a lot of mistakes made by the government. You alluded to housing. Economists for years have been saying, for example, that the tax subsidy that we have for homeownership in America doesn't make any sense. Now, we don't run for office, so we can say things like that. But we still say that. That is the law of the land. It overinvests in housing because of the tax preference.

And that Fannie and Freddie, the main mortgage institutions, were very weird institutions. They were sort of private, for-profit companies; they were sort of government. You don't really want the line to be that fuzzy. Why couldn't we decide, or break it into two, or something like that?

Those are just a few of the things, and then there was the under-regulation.

So the government was, absolutely, partly culpable, and so were the citizens, absolutely.

QUESTION: John Richardson.

If you take a Lehman Brothers or a Bear Stearns getting into trouble, the shareholders either get wiped out or drastically pruned down, and the expensive payroll diminishes. Similarly with householders who were overcommitted on the mortgage. They get wiped out sometimes.

What I don't understand is, is there an argument, or do you have an argument, that justifies what was done in the Lehman Brothers case? If there is such an argument—a moral hazard, whatever it is—why doesn't it apply to Citibank?

And does it justify what was done with the mortgage market?

ALAN BLINDER: When you get a chance to read my book, you will find a very long answer to that. It's a very good question. I'm going to give you a short answer right now.

The justification for sending Lehman to bankruptcy court changed several times as it came out of Hank Paulson's and Ben Bernanke's mouths. It started with things like moral hazard—that if we keep rescuing these things, everyone was going to expect to be rescued, and that will be horrible. It went through, "Well, six months have gone since Bear Stearns, so the markets are prepared for a bankruptcy of Lehman. Just look at the credit default spreads and stuff like that."

It wound up with—and this is what the Federal Reserve says to this day, and it's true, but I don't think it's a good answer—that we don't have the legal tools to rescue Lehman. This was before TARP. Once TARP passed, they did have the legal tools to rescue Lehman, but there was no such kitty of money that could have been used to save Lehman.

I don't accept that. Three days after the Lehman bankruptcy, Hank Paulson, the secretary of the Treasury, suddenly discovered the Exchange Stabilization Fund that was sitting over there in the corner. This was \$50 billion assigned by the Congress to stabilize the value of the dollar when necessary. Otherwise, it just sits there. All of a sudden he found this \$50 billion and says, "Oh, I'm going to use that to stop the run on the money funds."

It was a good thing to stop the run on the money funds. I'm not critical of that. But that was there when Lehman was going under.

Whether you have resources in a high government position like that—and the Fed is in the same basket here—depends very much on which lawyer you ask. You know there are some lawyers that are going to say, "No. That's illegal. You can't do that." And the Fed is loaded with lawyers like that, by the way. There are some lawyers who are going to say, "You know, it's probably all right. Who's going to sue you anyway?" That was the attitude at the Treasury on the money funds, but not at the time of Lehman.

So I think it was a mistake. What I think was the biggest problem here—and it was really part of your question, I think—is that we, the United States, had set up this precedent with Bear Stearns, followed again, in a different way, with Fannie and Freddie, of stepping in to make sure these companies didn't go to bankruptcy court in a chaotic way. The market had come to believe that was what was going to happen with Lehman Brothers. Then just like that, the game changes and financial market participants who thought they were playing baseball—which has occasional collisions, but not many—discovered they were on a football field. And panic then broke out.

The discrepancy between the treatment of Bear and the treatment of Lehman I think was a huge mistake in this. To my mind, if there should be an historical debate over what was right and what was wrong, it should be about Bear. Either you were going to draw the line at Bear—but if you didn't do that, we should never have let Lehman collapse the way it did.

QUESTION: Richard Valcourt.

The American public is still somewhat confused about the economic situation. You spoke of your disappointment with President Obama's communicating skills as they have been enacted. Even he has said he didn't get the story told right.

But [David Rothkopf](#) wrote in *The New York Times* just very recently that Obama is a terrible manager. Do you see any improvement in his ability and that of his cabinet in this second term, and especially also with [Mary Jo White](#) at SEC regarding enforcement?

ALAN BLINDER: I don't know about the last, because it's all in the future. We'll see what happens.

I read David's piece when he wrote it. I'm not sure I can think of a name of a president who was a good manager. It's not fundamentally a managerial job. You are the top dog. You're a little bit of a philosopher king, though not quite. You don't have the powers of a king. But the philosopher part is important. The communicator part is important. The cajoler-in-chief is important. Of course, the commander-in-chief is very important.

But it's a false analogy to compare the office of the president of the United States to the CEO of a big corporation. It's just not like that at all. Now, you do need some management, for sure. This is a big, sprawling enterprise. You need a good chief of staff, and he or she needs to have a good staff. You need cabinet officers. Many of those are managerial jobs. The secretary of defense, the secretary of

transportation, commerce—these are management jobs. So you need to choose good managers to do the managerial job.

Was Bill Clinton a great manager? No. I worked for him. I think he was a very good president, but he was not a good manager. Was Ronald Reagan a good manager? I don't think so. Was George Bush, who actually had some business experience, a good manager? Sure doesn't look it.

So I think that's just way overplayed. It's called chief executive, but I think it's a false analogy.

JOANNE MYERS: I have to thank you for being not only a philosopher, a communicator, but a good manager of the time here. Thank you very much.

Audio

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Video Clip

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