

Paulson's Conflicts Of Interest Spark Concern

As the financial markets took a turn for the worse over the past few weeks, conventional wisdom on Wall Street and Washington was that Hank Paulson, the Treasury Secretary, was the right man for the difficult job. A seasoned hand on financial matters, the former Goldman Sachs head had an acute understanding about how markets work, and had earned accolades from both political parties for his willingness to take a level-headed approach on these matters.

Now, however, confidence in Paulson is eroding, with critics questioning whether the Treasury Secretary's Wall Street connections have impacted his approach to the current crisis. Both progressive and conservatives are sounding the alarm.

"Some are saying that we should simply trust Mr. Paulson, because he's a smart guy who knows what he's doing," wrote Paul Krugman of the New York Times. "But that's only half true: he is a smart guy, but what, exactly, in the experience of the past year and a half -- a period during which Mr. Paulson repeatedly declared the financial crisis 'contained,' and then offered a series of unsuccessful fixes -- justifies the belief that he knows what he's doing? He's making it up as he goes along, just like the rest of us."

Then there was conservative pundit Michelle Malkin, hardly of the same ideological ilk of Krugman, who declared on Fox News: "I think that Hank Paulson's corporate...record is very important. While he was a Goldman Sachs, the company was buying up a lot of Chinese banks in particular, and at the time of his nomination, there were very serious questions raised about the conflicts of interest involved, and where his priorities are, and who he really is looking after."

Malkin was referencing the stipulation, in Paulson's bailout plan, for the U.S. Treasury to help prop up some foreign banks. But the main thrust of her point -- that Paulson's past mattered -- was echoed among economists, analysts, and lawmakers throughout Monday. Some of Paulson's former associates and colleagues are the very people he now is in position to help aid with taxpayer dollars. As McClatchy News reported, "Paulson's former assistant secretary, Robert Steel, left in July to become head of Wachovia, the bank based in Charlotte, N.C., that has hundreds of millions of troubled mortgage loans on its books."

Moreover, as Bloomberg News [reported](#): "Goldman Sachs Group Inc. and Morgan Stanley may be among the biggest beneficiaries of the \$700 billion U.S. plan to buy assets from financial companies while many banks see limited aid..."

On Monday, Oregon Democratic Rep. Peter DeFazio put a voice to this concern, warning House colleagues against being "rolled by a Wall Street executive who is masquerading as the secretary of the Treasury."

There is a certain irony to a former head of a major investment firm now being tasked with reforming the very system that made him so wealthy. Goldman, while never a huge player in the mortgage bond industry, nevertheless reported pre-tax earnings of more than \$6.2 billion in its trading division - which included such bonds - in 2005. Similarly, under lax federal oversight, Goldman's investment banking division had pre-tax earnings of \$413 million during that same year, according to an annual report.

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Having been steeped in this environment, observers argue, Paulson is seeking to tackle the current crisis from too narrow an angle; in essence, ignoring the cause (the failing housing market) in favor of the symptom (the crisis among investment banks).

"He does have potential personal conflicts of interest - not only regarding his associates, and his next finance position, but also the fact that part of his wealth almost certainly is in a blind trust that includes large holdings in Goldman Sachs and other funds," said Robert Shapiro, president of Sonecon and the undersecretary of commerce in the Clinton White House. "But even if Paulson is unaffected by such issues - and he may be, I just don't know - the more important issue is whether his former and future positions create a distorting prism for the bailout design. This crisis is ultimately driven by the falling housing market, and we will not finally get past it until the housing market stabilizes, which is why almost all economists say we're probably only halfway through this crisis. Yet, instead of trying to stop mortgage foreclosures and stabilize the housing market with loans to homeowners facing foreclosure, a Treasury headed by one of this period's leading investment bankers focuses only on loans and other bailouts for institutions that borrowed huge amounts to invest recklessly in the securities and derivatives based on those mortgages."

Economists have additional concerns with Paulson's approach, also related to the secretary's background. In his last report at Goldman Sachs, Paulson received a compensation package of \$38 million. And while he was reportedly instrumental in decreasing the size of the former New York Stock Exchange head Richard Grasso's golden parachute in 2001, others see him now as too willing to protect the earnings of the big-time CEOs in the current bailout proposal.

Then there is the issue of transparency and judgment. "I would borrow directly from Ronald Reagan, trust but verify," said James Galbraith, a professor of economics at the University of Texas, when asked about Paulson. "The guy is clearly competent. He has worked with Democratic leadership in the Congress very well. If this was John Snow still in the Treasury, there would be no question you couldn't do business. On the other hand, I wouldn't want to turn my back on him... This is a guy who thought he could weaken the SEC and even a couple of weeks ago, when he wanted advice on the risks with Fannie and Freddie, he went to Morgan Stanley."

To some extent, the political world is still grappling with how much responsibility Paulson deserves for the current crisis he has now been tasked with remedying. As it stands now, the Treasury Secretary still enjoys tremendous deference within the halls of power, with everyone from the Obama campaign to Michael Bloomberg and Mitt Romney expressing, at a minimum, basic confidence in his competency for the task. His past statements, specifically, his [declaration six months ago](#) that "our institutions, our banks and investment banks, are strong," is chalked up as a forgivable attempt to soothe public concern. And while backlash to his initially proposal for handling the financial crisis is growing on Capitol Hill, the consensus seems to be that - with the end of the Bush administration in site - criticism and vetting of Paulson won't be overtly intense.

"If this were to the end of Bush's first term and is going to be reelected, this stuff would matter more," said Steve Hayward of the conservative American Enterprise Institute. "But he is going to be gone in three months. It is the next Treasury Secretary who will be doing the deeds and overseeing the money."