Will Bush become the new Hoover?

By JEANNE CUMMINGS | 9/19/08 3:48 PM EDT

President Bush has long assumed the outcome of the Iraq war would define his legacy. But the catastrophic collapse of the housing bubble on his watch provides a new, perhaps more ominous, threat to how his stewardship will be ranked in history.

In a matter of weeks, an investment banking industry that survived the Civil War and the Great Depression virtually vanished from the scene, weighed down by faulty mortgages and other debts.

The Federal Reserve Board's role in the economy has been transformed in ways even economists say they can't yet fully appreciate, save for one: The government now has a dramatically bigger presence in the private market.

And the U.S. taxpayers are now likely to be put on the hook for hundreds of billions of dollars of faulty mortgages and already have become part-owners of a giant insurance house scheduled to be carved up and sold by the next administration.

"Bush runs a real danger of going down as a Herbert Hoover in this scenario," said Beverly Gage, a presidential historian at Yale University. "He could be seen as the man held responsible for what is happening who stood by and didn't forge a clear direction at a moment when a clear direction is what was needed."

Certainly, no president can control the course of history while in office. Hoover was elected in a boom economy in 1928 that went bust a year later.

But it's those very moments of calamity and uncertainty that offer presidents an opportunity to show their true mettle.

Thus far, Bush has not received high marks for his management of the housing crisis, particularly since it appears that his Treasury secretary has been running the show for the last three weeks.

It's a sharp contrast to 2001, when Bush's gravitas rose with his vigorous leadership after the Sept. 11 attacks in New York and Washington.

Among the most striking successes of his administration then was enabling the New York Stock Exchange to reopen in less than a week and send a signal that capitalism hadn't been beaten.
Bush used that fresh influx of political capital to launch the Iraq war even as U.S. troops were still hunting Osama bin Laden in Afghanistan. But mismanagement, mistakes and the misinformation about the need to go to war sapped the administration of credibility.

That has left the White House to argue that historians must wait for the long-term look at post-war Iraq to truly assess the wisdom of his foreign policy and presidency.

Now, Bush's domestic policy will go under a microscope as well. And, unlike in the foreign policy sphere, he was fully in control of his economic policies.

The sum of both is likely to be linked, says Gregory Hess, an economic expert at Claremont McKenna College.

Treasury's choice in recent days of which institutions to save and which to usher into bankruptcy showed a pattern: Those organizations with the widest international impact were saved.

Why? Because the U.S. must rely on those foreign entities "to continue to finance the U.S. deficit," which was run up to record levels in large measure because of the costs of the war in Iraq, said Hess.
Bob Bruner, business school dean at the University of Virginia, said the war deficits may also have reduced the number of options the government had to respond to the crisis.

"Perhaps under other circumstances, government would have been more inclined toward a tough love attitude" rather than a series of bailouts, said Bruner. "But, they couldn't chance it.'

In perhaps a cruel twist of fate, the Dow Jones on Monday experienced its biggest decline since the day the New York Stock Exchange reopened after the Sept. 11 terrorist attacks.

There are other ties between White House economic policy and the financial crisis.
One of the Bush administration's signature goals has been promoting an "ownership society." To achieve that end, the administration promoted a series of programs designed to encourage consumers to buy homes, stocks and other goods that would convert them into free market advocates. The one-time plan to privatize Social Security benefits fit into that portfolio.

With the Fed holding down interest rates after the terrorist attacks, the housing market took off and investors became increasingly creative — and reckless — in finding ways to cash in on the boom.
In 2005, subprime mortgages represented about 4 percentof the mortgage market. A year later, they accounted for 26 percent of the market, said Robert Shapiro, a former Clinton economic adviser.

"They knew the implications of this, the Fed and the Treasury," said Shapiro. "They saw what was happening to these securities."

Bush officials dispute that, arguing that the fast-moving transactions on Wall Street were difficult to assess since they were obtuse.

But the failure of the Bush administration to recognize the potential systemic risks in the rising home values and frantic selling seasons carries some ironies.

Bush took office from President Bill Clinton as the technology bubble was collapsing. Now, he will depart amid the wreckage of the housing bubble.

This calamity is more politically damaging than the tech bust was to Clinton because “this one hits much closer to the bone because it affects peoples’ use of net wealth,” said Hess.

“We had a lot of new homeownership. Now we have a lot of un-homeownership. It makes it that much more personal and that much more biting than the Clinton challenge,” he added.

The frantic effort by Treasury in recent weeks and months to contain the damage and stabilize the markets, has led to, as Bush said, “extraordinary” acts by the government.

It will take some time to sort out all of the ramifications of those acts, but it is clear that the next president will take over an economy transformed and changed in fundamental ways by Bush and his advisers.
The mortgage industry is likely to see new laws telling it how it can and cannot conduct business, a move that will insert government into the heart of the private market.

Financial institutions are certain to face a much tougher regulatory environment, which will mean higher business costs and bigger government — a striking result from an administration that came to power preaching the virtues of the free market and bent on diminishing the muscle of government regulators.
The distinctions between commercial and investment banks will end. That’s clear already as Merrill Lynch is absorbed by Bank of America and Morgan Stanley continues talks with Wachovia.

Barring congressional action, the Treasury secretary has gained enormous new powers, including the ability to essentially take over a private firm with only the slightest notice to the White House and Congress.

Economists will pour over those and other changes to assess the impact of the Bush presidency on the free market. Historians will look at the practical implications of the crisis, too, but they will also examine the leadership exhibited by president.

In the head-spinning succession of frightening headlines, the administration’s most public figures became Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke.

On Thursday, Bush made an unusual public appearance to offer brief remarks on the situation. The American people “are concerned” about the situation, he said. “And I share their concerns.”

But his comments seemed more notable for the assurance he chose not to give: that everything was going to be OK.

Bush made a second foray before the television lights on Friday, offering a more definitive and hopeful response.

He urged Congress to pass laws necessary for his administration to execute an enormous bailout of the financial industry.

It is one that will put the taxpayers on the hook for billions of dollars in home loans and other debt. It will also rid the New York financial houses of the rot and risk that their own investors seemed eager to accept not so long ago.

In the end, the taxpayer may come out ahead, as mortgages are reworked, home prices improve, and banks reopen their lending operations.

But, like the final outcome of the Iraq war, that won’t be evident by the time Bush leaves office and not, perhaps, for years to come.

In that sense, says historian Gage, Bush’s management of the war and the economic may ultimately be linked “in spirit, with each showing a certain recklessness, a lack of caution, and a rejection of the cautionary voices both within the administration and outside of it.”