

# Merger and Acquisition

The Bush administration lands a heavyweight for treasury secretary. **BY IRWIN M. STELZER**

**I**N MOST MERGERS it is easy to distinguish the acquirer from the acquired. Not in last week's highly publicized merger of Goldman Sachs and the White House. For the last two months, day-to-day operational control of the White House has been in the hands of a Goldman Sachs alumnus, Joshua Bolten, Bush's chief of staff. And now responsibility for economic policy has gone to Hank Paulson, who as secretary of the treasury will trade a \$40 million salary as Goldman's boss for one so small it won't be even a rounding error in his personal financial statement.

Still, George W. Bush retains the title of president and in the end will set the culture and policies of the newly merged Goldman Sachs-White House firm.

This is not the first time that these two leading firms have come together. Bill Clinton, who preceded Bush as the nation's CEO, wooed Bob Rubin from Goldman to the White House and then treasury, a merger that proved successful both for USA, Inc., which grew steadily, and for Rubin, whose reputation survived association with a standard of morality that would most definitely not have been tolerated at Goldman.

But beyond all this levity, the appointment of Paulson is important for several reasons. From the president's point of view, it shows that talk of the death of his administration is more than a bit premature.

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Washington was rife with rumors that the treasury job was going begging, that no senior figure would take it, and that Bush would be



**Hank Paulson**

forced to hand it to still another administration salesman.

The rumors were wrong. Paulson did take some persuading, but then a top Wall Street figure who has built a powerhouse financial firm would naturally be reluctant to leave the scene of his success. And there is no way that Paulson would have accepted a role subordinate to White House staff and agreed to act merely as a spokesman for, rather than a shaper of, the administration's economic policies.

So now the economic business of the nation is in the hands of heavy-

weights. Ben Bernanke at the Federal Reserve Board and his recently appointed vice chairman, Don Kohn, will provide professional and thoughtful guidance to monetary policy. Hank Paulson will add some sense and coherence to tax, trade, and environmental—yes, environmental—policy, as well as a firm voice when it comes to managing the next financial crisis.

Make no mistake, there will be a crisis. The merger deals that have brought smiles to the faces and millions to the coffers of investment bankers are so highly leveraged that a rise in interest rates could bring down many firms. New, complicated financial instruments have made many banks' risk-measurement tools obsolete. What Alan Greenspan terms the "unconscionable" inability of derivatives traders to introduce the technology needed to keep track of their trades is creating risks of unknowable magnitude. Add the volatility of commodity and share prices, and the possibility of steady increases in interest rates as inflation rears its ugly head, and there is ample reason to worry that there will be a crisis of some sort—not necessarily one that will bring the banking system down, as the self-styled economic geniuses who piloted Long Term Capital Management almost succeeded in doing in 1998, but one that will require both reassuring words from the treasury steps and a treasury secretary able to persuade all of the financial market's players to do their bit to right the boat.

There are other areas in which Paulson can be expected to make his authority felt. Remember: This is the man who did indeed herd cats at Goldman Sachs. He used tough talk to keep the firm's traders and investment bankers, who cordially despise each other, from tearing the firm apart. He is not likely to be cowed by the White House staffers who delight in devouring cabinet officers for breakfast.

Start with China. The Chinese know that they have to move their economy from one completely dependent on exports to one that relies in

Illustration by Drew Friedman

greater measure on domestic consumption. They know, too, that their banks are bust, and that capital is being allocated to inefficient firms for political reasons. And they certainly know that their policy of undervaluing the yuan is unsustainable, both because of the political pressures it is creating in America and because it is creating inflationary pressures at home.

What the Chinese can't figure out is how to dismount the tiger they are riding—an undervalued currency, more and more exports to create jobs to placate the millions leaving the farms for the cities—without being devoured by it. It is not beyond the realm of possibility that Paulson, who used his 70 trips to China since 1990 to become pals with a succession of Chinese leaders, has the authority and knowledge to help the Chinese move to a more sustainable model of economic development, holding off protectionists in Congress long enough to get the job done.

Then there is the environment, a policy area in which the Bush administration is in something of a time warp. No honest person can with certainty assert that global warming is a threat. But any responsible person can see that the evidence is sufficient to suggest that it might be, and that some action to contain emissions of greenhouse gases is an insurance policy worth having. Paulson is Wall Street's greenest titan, chairman of the Nature Conservancy, a bird-watcher, an advocate of a greenhouse gas emissions trading system for the United States and of mandatory curbs on emissions if voluntary action proves inadequate. At Goldman, he allocated \$1 billion for investment in renewable energy and energy-saving projects. He is likely to make his voice heard in an administration that is said to be ready to move from its justifiable opposition to the Kyoto treaty to more positive proposals for emissions reduction.

We can't, of course, note the coming of Paulson without commenting on the notion that treasury secretaries who hail from Wall Street favor a strong dollar policy, since they are

concerned with preserving the value of the dollar-denominated assets of their clients. Paulson is different: He is on record as favoring a gradual decline in the greenback. Besides, it is the market, not men—not even men of Paulson's skill and stature—that sets exchange rates. So long as America continues to run a trade deficit that is now on the order of 7 percent of GDP, the dollar will weaken. Not suddenly, but steadily. It is only if Paulson can bring the Chinese around to the administration's view as to what constitutes fair trade that he will be able to add to the dollar's strength. And that won't happen soon, and certainly not in a single bound.

Finally, Paulson can be counted on to steady the president's hand as he

reaches for his veto pen when the next wasteful spending bill hits his desk. So far, Bush has vetoed not even a single bill, no matter how profligate. Paulson is likely to change that and bring some fiscal discipline to administration policy. That should cheer those of the president's core supporters who are muttering about Lyndon Baines Bush.

There's more. But you get the idea. An administration not noted for the quality of its economic team now has one that would be difficult to improve upon. Paulson will speak to power from a position of power, for a Paulson resignation would be a wound from which the administration could not recover. Not a bad change in the structure of power in the Bush administration. ♦