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ECONOMIC NEWS UPDATE

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The Dynamic Trio: Paulson, Greenspan and Bernanke

We learned three lessons last week. The first is that geopolitical news does not always drive markets. Just as the increase in troop strength in Iraq seems to be damping down the killing, just as the Syrians and Iranians decide it would be a good idea to meet with the Iraqi government to see if some sort of modus vivendi can be worked out, just as Iran's Holocaust-denying, bomb-rattling president comes under pressure from moderates in Iran, the stock market tanks. If both good and bad geopolitical news drive down share prices, perhaps we should pray that traders skip directly to the business pages.

The second lesson is that politics trumps passion. I met last week with Treasury Secretary Hank Paulson at a session he convened to get some ideas on trade policy. Paulson, who has the bounce in his step denied to longer-serving members of the Bush admiration, described his "passion" for free trade. Most of the job losses we

have witnessed in recent years, he says, are due not to foreigners taking over US markets, but to changing technology that has, for example, replaced humans with robots on factory floors. The only way to continue to raise living standards is to keep the economy open and growing, a lesson that seems so obvious to Paulson that he is stunned that anyone can doubt it. But stunned he has been since coming to Washington. It is not only Democrats who are leaning towards protectionism, but many members of his own Republican party. The uniform advice of the think-tank denizens he gathered to advise him -- none threatened with loss of his job to lower-paid Chinese -- was for the Secretary to push forward with freer trade, and avoid new, expensive programs to assist those displaced by it.

Paulson is inclined to follow the first part of that advice -- fight for free trade. He dismisses worries about large foreign holdings of US debt for two

reasons. First, those holdings are widely diversified, providing protection against any run on the dollar by a single country. Second, "Where are foreigners going to go if they decide to cut their dollar holdings significantly?"

The Treasury Secretary is also unconcerned about America's current account deficit, which he attributes to the large inflow of foreign capital seeking a home in our strong economy. "The last time we had a trade surplus we were in recession," Paulson says, referring to the fact that recessions reduce consumer demand for imports and the attractiveness of dollar assets to overseas investors.

So much for the public meeting. In a private conversation Paulson turned to the question of assistance to workers displaced by trade, following up on my idea that unless the government addresses the plight of the losers -- honest working men and women who have played the game the American way and paid their taxes and educated their children -- support for free trade will dwindle further. It is after all, not only the displaced workers who are complaining to their congressional representatives, but those who still hold down good jobs but worry they might be next in line for the chop.

Paulson agreed that existing programs are not working, a view borne out the next day when The Wall Street Journal reported that few displaced workers can navigate through the paper work required by various assistance programs, or afford the portion of health insurance premiums that the government would not cover. My Hudson colleague, Diana Furchtgott-Roth points out that the President in his budget has called for consolidating the multiple assistance programs into four,

but so far congress isn't buying that approach. Whether Paulson will be able to rally political support for more sensible programs, including perhaps training vouchers that free displaced workers to bypass the bureaucracy and sign on to training most likely to result in good jobs, he says he just doesn't know.

But he did tell me that he knows something even more important: that the recent turmoil in the world's stock exchanges is unrelated to the health of the US economy. Coming from a politician or academic that would be less reassuring than it is former the former head of Goldman Sachs, a man who in his last year at the firm pocketed \$39 million for knowing a thing or two about markets. "The economic fundamentals are good," Paulson told me.

Which brings me to the third lesson of the week. Bernanke trumps, or at least equals, Greenspan in the influence rankings. Not that the former Fed chairman is without an audience, and a well-deserved one, given his history of noticing trends that are invisible to ordinary mortals. It was Greenspan, after all, who realized that the higher rate of productivity growth of recent years allowed the economy to grow faster than most thought, without triggering inflation. So no surprise that his warning that as the business cycle progresses "invariably forces build up for the next recession" added to the panic created by a sell-off in China, a glitch in the share-price reporting system, rising oil prices, a downward revision of fourth-quarter growth estimates, and more bad news from the housing and manufacturing sectors.

Enter Bernanke, testifying before congress. Greenspan's successor did not deny that sales of new homes dropped more than expected in January,

by 16.6%, leaving inventories too swollen to permit a recovery very soon. Nor did he attempt to explain away the news that fourth-quarter growth had been hit hard by drops in home construction and automobile output.

But neither did he ignore the February bounce in the level of manufacturing output and new orders, and recent increases in personal income, consumer spending and sales of existing homes. And he might have had in the back of his mind the idea that recoveries don't just die of old age, but meet an untimely end only from some external policy shock, including most notably policy errors of the sort the Fed made in the 1930s.

Bernanke balanced the good, the bad and the ugly and reported that his view is unchanged: "We are looking for moderate growth in the US economy going forward."

This stopped the bleeding, although not the volatility, and forced traders, now reminded that there is risk out there, to refocus on the prospects for the economy and the companies that comprise it, rather than on the views of even so revered prognosticator as the former occupant of Bernanke's chair.



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