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Former Top Paulson Lieutenant Now See Benefits of Bankruptcies Over Bailouts

Phillip Swagel was Assistant Secretary for Economic Policy under Henry Paulson at the Treasury Department from December 2006 to January 2009. In other words, he served during the height of the financial crisis. Today, he told me he now sees the benefits of bankruptcy over bailouts. It should be noted, Swagel was also a member of the TARP "investment" committee.

My opportunity to question Swagel came about because of his participation at a Cato Institute book forum where Robert Pozen's book, *Too Big to Save? How to Fix the U.S. Financial System*, was discussed. Pozen seems like a sharp guy. He is chairman of MFS Investment Management, which manages more than $170 billion in assets for mutual funds and pension plans. I'm sure his book is packed with all sorts of data and details about the financial crisis. If you are a financial historian, you can't ignore it. However, when detail turns to recommendations, he turns out to be an interventionist. Thus, the book will confuse the average reader trying to understand the crisis. I almost choked when he called the structure of the bailouts, "one way capitalism." Of course, as Michael Labeit has explained what has been going on has little to do with capitalism, one way, two way or HOV lane.

Pozen also seemed to think of every financial crisis as separate and distinct, so during the Q &A I asked him if there was anything like a business cycle theory that could explain these cycles, or was each crisis separate and distinct. He thought for a minute and then said that, in emerging countries, crises seemed to be caused by currency panics and in the United States they seemed to all be the result of high leverage. I took this to mean he had no clue of any underlying factors that could be causing these recurring cycles.

I hesitate to point out that Pozen is a senior lecturer at Harvard Business School, in addition to being the chairman of an investment firm overseeing $170 billion. There wasn't any awareness in his eyes of any business cycle theory, not only didn't he bring up Austrian Business Cycle theory, he didn't bring up the Friedman/Schwartz view of what caused crisis, or for that matter Keynes' theory of a failure of aggregate demand. It was as if a teacher had called on the dumbest kid in class to go up to the blackboard and answer a question. You just settle into your seat and try and guess how you might be entertained, and they always surprise you. I really thought he might even get in the ballpark with some kind of Keynesian nonsense, but these guys just don't think in terms of the possibility of a general business cycle theory.

But my main purpose wasn't to send Pozen to the blackboard. It was to truly understand what Phillip Swagel did while he was Assistant Treasury Secretary, since I already discovered, in our last encounter, that he wasn't watching money supply.

So as the Pozen book forum finished, I headed up to the sandwich buffet that Cato is kind enough to provide, where I staked out my target. The sandwiches provide the fuel I need to battle on, and they also serve as bait.

So I picked a spot from where it would be easy to spot Swagel as he headed toward the sandwiches. As I munched on a turkey sandwich, I spotted him. There was still quite a line at the buffet, so I figured I had plenty of time to finish my sandwich before he would even get to the buffet, but Swagel cut to the front of the line. I realized quickly that I would have to pick up and move my plate and sandwich and head to whatever table he would go to. But he circled the sandwich table twice. I mean he really circled like a guy who had bought much too much junk mortgage syndicated securities, looking for any crumb that might have value, and then he walked away. He then swarmed a table with potato chips and then a table with Fritos. But nothing seemed to be appealing to him, maybe it was just a knee jerk reaction he had to everything after being a member of the TARP "investment" committee. Now, he was heading out toward the revolving door.

I wasn't going to be able to finish my sandwich. I dropped it to my plate, left it, a few chips and a coke and rushed to the door.

Fortunately, a very beautiful, in a wholesome way, college age girl stopped him to ask a question. He gave his full attention to her (This would not be hard to do.) It gave me the chance to catch up. And I stood there marvelling at the fact that this beauty, who resembled a young Sophia Loren, was also interested in economics.

When Swagel finished his question, I moved into action quickly. His foot was almost in the revolving door. "Hi, Phil," I said, "You know I have been thinking. I know you were at the Treasury, but I am wondering, if you know about any gold swaps or leases the Fed has been conducting?"

His answer shocked me. He said, "You mean, currency swaps?" "No," I said, "has the Fed been doing any gold swaps or gold leases of any kind?" He seemed completely confused. He said to me he had never heard of gold leases or swaps. I said, "Well, I think they are very interesting." He took his pen and wrote on the corner of his notes "gold leases."

Now, what is curious about this statement is that although the Federal Reserve doesn't include any footnote on its balance sheet about gold swaps or leases, the Treasury does so on its weekly U.S. International Reserve Position. Footnote 3 reporting on the same gold position says,

> (4) gold (including gold deposits and, if appropriate, gold swapped)

Now, Swagel has to be totally clueless, or he is not shooting straight.

During the book forum, he got very animated, acted like he was disgusted, and said it was terrible that the Federal Reserve has become so unpopular. He said it was doing a great job. This from a guy, when I put him on the spot this spring, admitted he didn't know what money supply growth was in the summer of 2008, before the crash. And now he says he doesn't know what a gold lease is. And , he is going to pontificate to the public about how good a job the Fed is doing, when he either doesn't know what the Fed is doing, or wants to hide from public view what the Fed is doing.

He seemed to want to change the topic, and he seemed to be a bit more nervous talking to me, than when he was when he talking to the college coed. His gestures were very jerky and fast. This is when he volunteered that he was now coming to believe that bankruptcies made more sense than bailouts.

I asked him what insights Goldman CEO Lloyd Blankfein brought to the AIG bailout meetings. He said,"On no, I wasn't at those meetings." That did it.

He was through the revolving door, and down the street in the cold and rain, without even stopping to put his umbrella up.