Questioning the Treasury's $700 Billion Blank Check: An Open Letter to Secretary Paulson

AARON S. EDLIN

Dear Secretary Paulson,

Today, I read the U.S. Treasury's humble request for the authority to spend 700 billion taxpayer-owned dollars. This taxpayer's answer: "No."

Sorry, Mr. Paulson, for the vote of no confidence, but consider the terms you propose. The only hard restriction on this gift certificate is that it must be redeemed at "a financial institution having its headquarters in the United States" and used to buy "mortgage-related assets." You will have little trouble spending this bounty, probably all before election day.

I did notice the soft restriction, with the two "Considerations" that you are intended to "consider" in your purchases: "(1) providing stability or preventing disruption to the financial markets or banking system; and (2) protecting the taxpayer."

It is kind of you to remember the taxpayer, but will you forgive me for being a little concerned when your proposed legislation provides no clue how you are to balance these two considerations nor what constitutes adequate protection of the taxpayer?

Just as I am wondering whether you are allowed by chance to pay inflated prices for assets if you should so choose and if you judge it to promote "stability," I come upon the fact that your decisions will be "non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency."

I stopped dead on reading this. You, the Treasury Secretary, are really asking for a $700 billion blank check.

The legislation does not even suggest that you should try to get a fair price, not anyway if "stability" is at stake. And if you decide to give twice the fair price to an old friend from your Goldman Sachs days and think this contributes to stability, that decision is non-reviewable. What a job you have! To think that only last week I felt sorry for you.

You could under this legislation pay $700 billion for "paper" having a face value of $800 billion even though the paper's market value has sunk to $100 billion or even though the

Aaron S. Edlin holds the Richard W. Jennings Endowed Chair and is Professor of Economics and of Law at the University of California, Berkeley, and a Research Associate at the National Bureau of Economic Research. He is co-author with P. Areeda and L. Kaplow of a leading antitrust casebook. He was formerly the Senior Economist covering regulation, antitrust, and industrial organization at the President's Council of Economic Advisers, and has taught or held research positions at Yale, Stanford, and Columbia.

paper has no market, so long as you think the purchase promotes stability sufficiently. You could do so with no review and no appeal. I suppose, taking the words of your legislation literally, you could spend the entire $700 billion buying a single mortgage owned by Goldman Sachs if you thought such a cash injection was just the trick.

To be sure, you might be successfully challenged in court on the more ludicrous hypothetical purchase, despite the no-judicial review clause. On the other hand, I can well imagine Justice Scalia's opinion scolding Congress for not drafting better and telling the plaintiff to pound sand.

Regardless of such far fetched possibilities it is clear that the proposed legislation gives you nearly complete authority to make bad deals in the name of stability—bad deals for taxpayers and good for your brethren on Wall Street.

And here is a disturbing thought: if the initial tab is $700 billion, is it possible you may wind up coming back for much more? Could the administration that brought us the $2 trillion dollar war bring us a $2 trillion dollar bailout?

Finally, would it be over-the-top cynical to worry that after you give some investment bank a particularly sweet deal that the bank or its employees would later decide to spend some of that money in campaign contributions or political action committees?

I dearly hope this legislation is not passed as it stands. If anything like this bailout must be done, I propose putting Warren Buffett, and not Henry Paulson, in charge. Warren Buffett and Charlie Munger have a strong history of getting assets at a discount when sellers need liquidity. The goal should be stated in the legislation: Buy assets at a bargain in cases where the purchase will improve the stability of the financial markets or the banking system. The alternative to selling should be a quick trip to a special panel of bankruptcy judges ready to impose a debt for equity swap, as proposed by Luigi Zingales.

The government made a profit on the Chrysler bailout and I see no reason why that shouldn't happen here. No reason that is, except the proposed legislation.

Letters commenting on this piece or others may be submitted at http://www.bepress.com/cgi/submit.cgi?context=ev.

REFERENCES AND FURTHER READING

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