

“It’s Credit – Stupid!”
By Peter J. Solomon and Anders J. Maxwell

Secretary Paulson has united the country – in opposition to the bill to bail out the global credit markets and, as usual, the country’s got it right.

We need a plan – make no mistake. Forget the volatility of equity markets – they are only the telltale of our economic condition. It is the global credit markets which are seizing up and threatening economic stability.

Simply stated, the \$3.5 trillion commercial paper market – which finances the short-term credit of U.S. corporations – is on the brink of drying up, the result of which would be a “run” on the already illiquid banking system.

Action is required – today or tomorrow – not to save Wall Street but to permit the on-going financing of American business and consumers. It’s credit – stupid!

Focus! The Paulson bill does not do the job! What a quandary faces Congress. Pass any bill to forestall calamity knowing, at the same time, the law is ineffective and impractical as a more permanent solution. And, can you beat this — the author Paulson will be jobless in three months.

The markets need funding – but like Warren Buffett just provided to Goldman Sachs and the Treasury provided AIG. The Treasury’s plan may provide instant liquidity, but it fails to address the underlying issue; namely, the markets need the funding necessary to support refinancings. Paulson’s plan fails to address this instant requirement. Ironically, it risks another round of mis-valuation of assets at the expense of the U.S. taxpayer, usurps the market’s role of price setting, and removes accountability and prospects for eventual loss or gain from the managements and investors who placed these bets in the first place.

The Depression era Reconstruction Finance Corporation was a successful model from 1929 through WWII. It accomplished funding of illiquid and under capitalized private companies such as banks by investing in preferred stocks. The RFC invested \$3 billion and got back \$3 billion. It was an independent agency with legislative over-sight. It was run professionally.

The Administration has chosen as its model the Resolution Trust created in the 1980’s to handle the savings and loan crisis. It was run by the Treasury. Taxpayers lost almost \$300 billion. The market was too smart for even the best of our politicians and bureaucrats. Private sector sharpies picked the Treasury’s and taxpayers’ pockets.

Given the history and recent experience, the Paulson proposal is inexplicable – and like many inexplicable events – no testimony has clarified it. The best we can fathom is the Treasury will hire experts

to evaluate the securities that we, the taxpayers, are buying. Who is the Treasury going to hire? The people who sold the securities to the public in the first place.

In short, there are two problems with the Plan. First, it does not provide immediate funding.

Secretary Paulson should know this – after all he ran Goldman Sachs, one of the dominant players in the game he now decries.

By usurping the market and setting price, the Plan exposes the taxpayer to losses far exceeding those incurred by the RTC.

Alternatively, follow Buffett's example. Invest the \$700 billion in viable financial institutions deemed beneficial to the public interest. Delegate decisions to experienced and disinterested professionals – not politicians.

This and subsequent Administrations and Treasury Secretaries have no business setting the values of securities. The magnitude and risk of the undertaking demand an equity return for taxpayers. Neither of these prerequisites is respected by the current Plan. It's bad politics and it's bad business.

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Peter J. Solomon is Founder and Chairman of Peter J. Solomon Company, L.P., an investment banking advisory firm, and is regarded as an expert in the retail business. He is former Counselor to the Secretary of the Treasury under President Carter, former Deputy Mayor for Economic Policy and Development under Mayor Edward I. Koch and former Vice Chairman of Lehman Brothers.

Anders J. Maxwell is a Managing Director at Peter J. Solomon Company, L.P., and concentrates on corporate restructuring and strategic sales.