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Paul O'Neill: Blunt Talk About the Crisis

President Bush's first Treasury Secretary on the root causes, the Paulson plan, the House vote defeating it, and more

by Maria Bartiromo

As *BusinessWeek* went to press on Oct. 1, the U.S. Senate was scheduled to vote on a new version of the financial bailout plan. To get a fresh perspective on the crisis and the original proposal pushed by Treasury Secretary Hank Paulson, I called one of the straightest talkers ever to serve at both the top of Big Business and the pinnacle of Washington, Paul O'Neill. In the 1970s, O'Neill was deputy director of the Office of Management & Budget. From 1987-1999, he was CEO of Alcoa (AA) and was then recruited by an old pal, Dick Cheney, to be Treasury Secretary for new President George W. Bush. But after a falling out with Bush, he left his Cabinet post in 2002 and collaborated with journalist Ron Suskind on a scathing account of his tenure entitled *The Price of Loyalty*. O'Neill is now a special adviser to Blackstone Group (BX), the private equity firm.

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A lot of ordinary citizens were confused about the Paulson plan that was defeated by the House. Was that House vote a blunder or a vote for U.S. taxpayers?

PAUL O'NEILL

I think it was an act of cowardice by individual members caring more about getting reelected than doing what needed to be done.

If you were still Treasury Secretary, what would you do?
I have no doubt that we need to reliquefy the markets, but I think there's a better way to do it. Rather than buying these [troubled financial] instruments, I think the Treasury should have the authority to guarantee them. As soon as you put a government guarantee on an instrument, it's going to trade just like a government bond or like cash. Why should we own them when we can accomplish the liquidity purpose with a guarantee? That may not be enough for some institutions with a whole lot of this toxic paper, but I think we ought to treat the institutional issues separate from the liquidity issues.

Why has there been so much trouble getting something passed?
The marketing [of the original Paulson plan] was terrible, and I think that's a consequence of the Treasury and the Fed and some members of Congress being in a panic. I suppose their notion was if we say $700 billion, that'll get everyone's attention and the markets will be calm because it's such a large number. And letting it be portrayed as a bailout was a terrible idea. The crucial thing we need to do here is liquefy the credit market, and guaranteeing the instruments is a lot different than guaranteeing the institutions. It's not clear to me that this is the last issue we're going to encounter—whether we have a buying program or a guarantee program. Two weeks ago no one saw the money-market crisis coming.

Should we be bailing out firms like Bear Stearns?
I don't think we ought to be bailing out institutions.

Is the Treasury Secretary being given too much power?
I don't see this so much as putting power in his hands as authorizing the executive branch to take action to reliquefy the credit markets. I'll tell you what, if they do start buying $700 billion worth of property or paper with property

underneath it, I'd sure as hell hate to be the next Secretary of the Treasury. It's going to be a nightmare. There is no federal institution in existence, nor is it possible to create one, that can actually manage a $700 billion property portfolio.

John McCain has called for SEC Chairman Christopher Cox to be removed. Was Cox asleep at the wheel?
No. It's an unfortunate example of what happens when people are making snap comments in the throes of a political campaign. Maybe Cox is not the best SEC chairman ever, but it's not appropriate to call for his resignation when we've got a liquidity problem to deal with.

But who should have been overseeing the investment banks as they took on all that risk?
I think before this thing blew up, Paulson was trying get a change in the regulatory scheme enacted. I'm a fan of clearheaded requirements for the financial system. One thing I would do, for example, on the homeownership front is make it illegal for anyone to give or take a mortgage without a 20% down payment so we'd always have a cushion between disaster and ongoing mortgage payments. When they think about regulation, I hope they think about clear and measurable things. It's not necessary to have field armies of bureaucrats second-guessing people in the financial system.

Has there been a failure of economic leadership by President Bush?
I think he doesn't understand an awful lot about these complicated things in the financial markets. And his approval ratings are so low and his ability to move people in his own party is so limited that it doesn't matter [what he does].

What is the root cause of this crisis?
A combination of things. It begins with the stupid idea that you can put people in homes who have no income, no wealth, no regular job history. [Then there's the notion] that in this marvelous world we've created of complex financial instruments, the originator of the loan can throw [the mortgage] out into cyberspace and someone will put a guarantee on it and it'll be amalgamated with a bunch of other stuff. And even though there may be a 3% to 5% risk of default, that's a manageable risk, and nobody will get hurt. It's all a fiction.

How are nonfinancial CEOs feeling today?
Until the last few weeks, the ones I talk to have been looking at order books that were good and pricing that was good. They hadn't yet been affected. But there seems to be mounting evidence that it's difficult to get working capital loans. If it's true people aren't able to meet payroll, that's a crisis.

Then what happens to the economy and the markets?
The markets freeze up. In the most extreme case, people go to the gas station, swipe their credit card, and the machine says cash only. We revert to a cash-only economy, which is a disaster for us. The next step is barter, which is what happened in Germany in 1923.

Maria Bartiromo is the anchor of CNBC's Closing Bell.