What If There's Another *Financial Crisis?*

By James Pethokoukis

Washington seems unprepared.

What will ignite the next conflagration that scorches global economies and financial markets? There are lots of obvious candidates: A surprise rise in interest rates after years of quiescence. Another European sovereign debt crisis, perhaps centered around Italy. A sharp downturn in the Chinese economy as the trade war with America escalates. Or maybe it will be a true black swan, a highly improbable event that hardly anyone is considering right now—but will make some sharpie a billionaire multiple times over.

The only thing absolutely for sure is that more financial shocks will come—and probably not infrequently given the track record of the past few decades, from the Latin American debt crisis of the 1980s to the Asian financial crisis of the 1990s to the housing and banking crisis of just a decade ago. And when the next crisis comes, which Americans will be there to save the world? Back in 1999, *Time* magazine ran a cover story with the picture of Federal Reserve Chairman Alan Greenspan, U.S. Treasury Secretary Robert Rubin, and U.S. Treasury Undersecretary Lawrence Summers, labeling them the "Committee to Save the World" for their financial fire-fighting prowess. It was a team of great experience, industry and political connections, and intellectual capacity.

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But as certain as it is that another crisis will happen, it might be equally uncertain whether Washington is prepared to act effectively and efficiently. The current Fed chair, Jerome Powell, does not seem to have the confidence of the Trump White House and could be replaced in a second term by a highly unorthodox selection. The current Treasury Secretary, Steven Mnuchin, seems to have the support of the president, more or less, but maybe not that of financial markets. And the Treasury Department itself still has key positions left vacant or filled with lightly qualified appointees compared with previous administrations.

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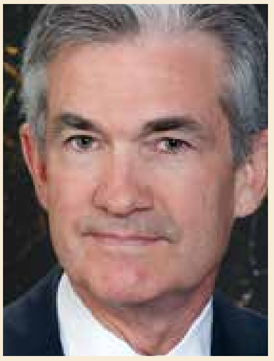
Now on paper, at least, there were few people better suited than former Fed Chair Ben Bernanke to lead America's central bank through a global financial shock and near depression. Bernanke was a student of the Great Depression who understood how monetary policy could either ameliorate or aggravate a crisis. And while the Bernanke-led Fed's policy creativity during the downturn and crisis—especially the multiple rounds of bond buying—have been criticized by some, not only did the American economy stay out of depression but the subsequent recovery is now part of the longest expansion since at least the 1850s.

Current Fed Chair Jerome Powell was not at the Fed during the heart of the crisis, joining in 2012. But Powell is well versed in how the economy performed in its aftermath, and in the many policy debates concerning the Fed's crisis performance and how the central bank should deal with future shocks. In addition to his fluency on modern monetary policy, Powell also brings a deep business background to the table—he is a former partner at the Carlyle Group and started his own private equity fund—and served at Treasury during the early 1990s, including as undersecretary for domestic finance.

Like Bernanke, Powell seems well suited to be a capable future crisis fighter. Two problems, though: First, President Trump seems to have as little public confidence in his central banker as any president in American history. Trump has repeatedly blamed the Powell Fed for undermining the economic expansion by keeping interest rates too high. As the president tweeted in June: "Think of what it could have been if the Fed had gotten it right. Thousands of points higher on the Dow, and GDP in the 4's or even 5's. Now they stick, like a stubborn child, when we need rates cuts, & easing, to make up for what other countries are doing against us. Blew it!" Yet in the event of new economic tumult, markets will need to be confident that the White House trusts and respects the Fed as both work in concert to deal with the crisis.

Who You Gonna Call?



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Second, Powell may not get another term as Fed chair. And some of the unorthodox people that the president has been considering for Fed governorship would be worrisome if they joined the bank and were later elevated to the top job. For instance, Trump recently tweeted that he intends to nominate former campaign adviser and economic analyst Judy Shelton to the Fed board. If approved by the Senate, she would have to be on any short list of potential Powell replacements in a second term. But her ascent to Fed chair would raise questions about how she would handle a crisis. Her support of the gold standard and deep fear of inflation that often accompanies such support suggests Shelton might be reluctant to act forcefully to stimulate aggregate demand. She told the *Wall Street Journal* in 2016 that the Fed's policy of "ultralow interest rates" in the wake of the financial crisis has "flooded wealthy investors and corporate borrowers with cheap money, while savers with ordinary bank accounts have been obliged to accept next-to-nothing returns."

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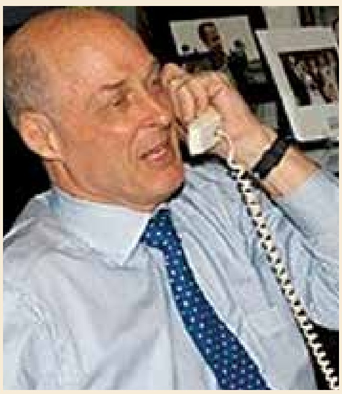
A new Committee to Save the World would of course also include the current Treasury Secretary, Steven Mnuchin. Next to the Fed chair, no person would be more important in a crisis. Recall that back in 2008, it was Hank Paulson who told the chief executives of the country's nine largest banks that they had no choice but to accept capital infusions. Not only was he George W. Bush's Treasury Secretary, but Paulson was a long-time Wall Street veteran whose last job had been as chairman and chief executive officer of Goldman Sachs. How would Mnuchin, another Goldman Sachs veteran, perform in a crisis? Some critics would point to the events of December 2018 as suggesting reason for concern.

News broke on Friday, December 21, that Trump had discussed firing Powell after the Fed's interest rate hike earlier in the week and the S&P 500 suffering its worst week in a decade. At 7 p.m. on Saturday, Mnuchin tweeted "I have spoken with the President @realDonaldTrump and he said 'I totally disagree with Fed policy. I think the increasing of interest rates and the shrinking of the Fed portfolio is an absolute terrible thing to do at this time, especially in light of my major trade negotiations which are ongoing, but I never suggested firing Chairman Jay Powell, nor do I believe I have the right to do so.'" This hardly cleared things up, given that Trump could have easily tweeted that opinion or released a formal statement if it was how he actually felt.

On Sunday, Mnuchin phoned the leaders of six banks—J.P. Morgan Chase, Wells Fargo, Goldman Sachs, Citi, Morgan Stanley, and Bank of

The U.S. Treasury's Thin Bench



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If Mnuchin or any successor is to perform better in a more serious crisis, they'll need an effective team at Treasury. But the bench is awfully, even dangerously, thin. Key positions, at the under, assistant, and deputy assistant secretary level—all of which proved crucial to Paulson in abating the last financial crisis—have been left vacant or are filled by those seemingly underqualified for the job. Of the sixteen undersecretaries or assistant secretaries that make up the core of the department's decision-making apparatus, only eight positions are filled permanently and only six have been confirmed by the Senate.

By comparison, all but one of the top spots in Secretary Hank Paulson's Treasury Department was filled at the start of 2008 when the financial crisis really escalated. Of course, a slow Senate confirmation process, which has become par for the course in recent administrations, is at least partly to blame for this lack of talent at the top. But equally troubling is Secretary Steven Mnuchin's apparent preference for a lean staff and empty hallways, which *Politico* notes has led to "an 8.3 percent decrease in overall staffing at the department since fiscal year 2016."

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America—from a resort in Cabo San Lucas, Mexico, where he was vacationing with his family. After the call, Mnuchin released a statement claiming that each bank had "ample liquidity" to lend to consumers. Both moves were seen as an attempt to calm the market after Trump's comments and the previous week's losses. On Monday, Mnuchin also convened a brief call of the President's Working Group on Financial Markets, which was created after the

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1987 stock market crash and is often referred to as the "Plunge Protection Team."

Mnuchin's efforts seem only to have left investors baffled and made matters worse, with the markets closing a truncated Christmas Eve trading day sharply down, with the Dow falling 653 points and the S&P 500 nearing bear market levels. According to CNN, "The CEOs who spoke individually by phone Sunday with Mnuchin were 'totally baffled' by the sessions, finding the encounters puzzling and largely unnecessary. 'It was totally out of left field and an odd thing to do,' said one participant, describing the timing of the calls—on a Sunday ahead of Christmas before markets opened—as strange."

Analysts across Wall Street were equally critical. "We do not see this type of announcement as constructive and worry that it can trigger the very panic that Treasury wants to avoid," Cowen Washington Research Group analyst Jaret Seiberg wrote in a note to clients. "It signaled a sense of panic and anxiety that didn't need to be there," said Brian Gardner, an analyst at the investment banking firm Keefe, Bruyette & Woods. "It seems like the government and [Trump's] advisors can't get out of their own way," said Jack Ablin, chief investment officer at Cresset Wealth Advisors in Chicago. "Already there's a fair amount of uncertainty or lack of confidence in their ability to lead, and Mnuchin's move just reinforced that concern."

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A Key Position Still Empty

Of particular importance to U.S. Treasury Secretary Hank Paulson during the financial crisis was David McCormick, the Treasury's under secretary for international affairs. In his 2010 book, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System,* Paulson describes how McCormick helped guarantee a much-needed $9 billion investment in Morgan Stanley from a Japanese bank just weeks after Lehman Brothers collapsed. At the same time, Paulson credits McCormick with managing the concerns of international investors, finance ministers, and central bankers over the U.S. government actions, all the while maintaining constant contact with the Chinese government in an attempt to convince Chinese banks not to flee money market funds. McCormick's deft, if not well-known, leadership comes as no surprise given his extensive experience, which included time as Bush's deputy national security advisor for international economic policy, a Ph.D. from Princeton, and military service during the First Gulf War. Today this crucial position is empty, as Trump's designee, Brent McIntosh, awaits Senate confirmation.

Further, the Office of International Affairs, which McIntosh would head if confirmed, does not have a single Senate-confirmed official serving in its three dedicated secretarial positions. What's more, this office, which is the epicenter for trade policy at Treasury and crucial in Trump's numerous international trade negotiations, has seen an exodus of more than twenty high-level career civil servants since 2017, including some of its most experienced China hands.

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David McCormick, *Under Secretary of the Treasury for International Affairs, August 2007–January 2009.*

Brent McIntosh, *current general counsel of the U.S. Treasury and nominee for Under Secretary of the Treasury for International Affairs.*

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Given the lack of staff in Treasury's Domestic Finance and International Affairs divisions—typically its most important—it is not exactly clear who would serve as Mnuchin's "brain trust" during a crisis. In 2008, Paulson was known to frequently gather Under Secretary for Domestic Finance Bob Steel with Assistant Secretaries David Nason, Phillip Swagel, and Neel Kashkari to help develop and discuss the Treasury Department's response to the crisis, with the team responsible for coming up with everything from the federal takeover of Fannie Mae and Freddie Mac to the Troubled Asset Relief Program.

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The Great Recession and Global Financial Crisis were epochal events, the effects of which are still being felt. But it could have been far worse. At the nadir, it certainly did look like, as Bush said, "this sucker is going down." And while future crises may not be as dire, it will be up to smart policymakers to make sure brushfires don't become raging forest fires. Fully staffing government with capable, experienced people should be a top priority for this or any future president. Not only do we not know what will start the fire next time, we're all pretty fuzzy on who's going to fight it. ◆