

U.S. DEPARTMENT OF THE TREASURY

Press Center

In Case You Missed It: "Fighting the Financial Crisis, One Challenge at a Time"

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By Secretary Henry M. Paulson, Jr.

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We are going through a financial crisis more severe and unpredictable than any in our lifetimes. We have seen the failures, or the equivalent of failures, of Bear Stearns, IndyMac, Lehman Brothers, Washington Mutual, Wachovia, Fannie Mae, Freddie Mac and the American International Group. Each of these failures would be tremendously consequential in its own right. But we faced them in succession, as our financial system seized up and severely damaged the economy.

By September, the government faced a systemwide crisis. After months of making the most of the authority we already had, we asked Congress for a comprehensive rescue package so we could stabilize our financial system and minimize further damage to our economy.

By the time the legislation had passed on Oct. 3, the global market crisis was so broad and so severe that we needed to move quickly and take powerful steps to stabilize our financial system and to get credit flowing again. Our initial intent was to strengthen the banking system by purchasing illiquid mortgages and mortgage-related securities. But the severity and magnitude of the situation had worsened to such an extent that an asset purchase program would not be effective enough, quickly enough. Therefore, exercising the authority granted by Congress in this legislation, we quickly deployed a \$250 billion capital injection program, fully anticipating we would follow that with a program for buying troubled assets.

There is no playbook for responding to turmoil we have never faced. We adjusted our strategy to reflect the facts of a severe market crisis, always keeping focused on our goal: to stabilize a financial system that is integral to the everyday lives of all Americans. By mid-October, our actions, in combination with the Federal Deposit Insurance Corporation's guarantee of certain debt issued by financial institutions, helped us to accomplish the first major priority, which was to immediately stabilize the financial system.

As we assessed how best to use the remaining money for the Troubled Asset Relief Program, we carefully considered the uncertainties around the deteriorating economic situation in the United States and globally. The latest economic reports underscore the challenges we are facing. The gross domestic product for the third quarter (which ended Sept. 30, three days before the bill passed) shrank by 0.3 percent. The unemployment rate rose in October to a level not seen since the mid-1990s. Home prices in 10 major cities have fallen 18 percent over the previous year. Auto sales numbers plummeted in October and were more than a third lower than one year ago. The slowing of European economies has been even more drastic.

I have always said that the decline in the housing market is at the root of the economic downturn and our financial market stress. And the economy, as it slows further, threatens to prolong this decline, as well as the stress on our financial institutions and financial markets.

A troubled-asset purchase program, to be effective, would require a huge commitment of money. In mid-September, before economic conditions worsened, \$700 billion in troubled asset purchases would have had a significant impact. But half of that sum, in a worse economy, simply isn't enough firepower.

If we have learned anything throughout this year, we have learned that this financial crisis is unpredictable and difficult to counteract. We decided it was prudent to reserve our TARP money, maintaining not only our flexibility, but also that of the next administration.

The current \$250 billion capital purchase program is strong medicine for our financial institutions. More capital enables banks to take losses as they write down or sell troubled assets. And stronger capitalization is essential to increasing lending, which is vital to economic recovery.

Recently I've been asked two questions. First, Congress gave you the authority you requested, and the economy has only become worse. What went wrong? Second, if housing and mortgages are at the root of our economic difficulties, why aren't you addressing those problems?

The answer to the first question is that the purpose of the financial rescue legislation was to stabilize our financial system and to strengthen it. It is not a panacea for all our economic difficulties. The crisis in our financial system had already spilled over into the overall economy. But recovery will happen much, much faster than it would have had we not used TARP to stabilize our system. If Congress had not given us the authority for TARP and the capital purchase program and our financial system had continued to shut down, our economic situation would be far worse today.

The answer to the second question is that more access to lower-cost mortgage lending is the No. 1 thing we can do to slow the decline in the housing market and reduce the number of foreclosures. Together with our bank capital program, the moves we have made to stabilize and strengthen Fannie Mae and Freddie Mac, and through them to increase the flow of mortgage credit, will promote mortgage lending. We are also working with the Department of Housing and Urban Development, the F.D.I.C. and others to reduce preventable foreclosures.

I am very proud of the decisive actions by the Treasury Department, the Federal Reserve and the F.D.I.C. to stabilize our financial system. We have done what was necessary as facts and conditions in the market and economy have changed, adjusting our strategy to most effectively address the crisis. We have preserved the flexibility of President-elect Barack Obama and the new secretary of the Treasury to address the challenges in the economy and capital markets they will face.

As policymakers face the difficult challenges ahead, they will begin with two considerable advantages: a significantly more stable banking system, one where the failure of a major bank is no longer a pressing concern; and the resources, authority and potential programs available to deal with the future capital and liquidity needs of credit providers.

Deploying these new tools and programs to restore our financial institutions, financial markets and the flow of lending and credit will determine, to a large extent, the speed and trajectory of our economic recovery. I am confident of success, because our economy is flexible and resilient, rooted in the entrepreneurial spirit and productivity of the American people.