

The Economic Club of New York

498th Meeting
111th Year

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Chief Executive Officer, Warburg Pincus, LLC
Former U.S. Secretary of the Treasury

and

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Introduction

Chairman Marie-Josee Kravis

I'd like to welcome you to the 498th meeting of the Economic Club of New York in our 111th year. And I'm Marie-Josee Kravis, the Chair of the Club. Before we continue and I make the introductions, I would like to remember a past speaker at the Club, the 41st President of the United States, George Herbert Walker Bush. During today's National Day of Mourning, we celebrated the life of a great statesman and a caring and compassionate man. And I would like to ask you to please pause for a moment of silence in his honor.

Moment of Silence

Marie-Josee Kravis: The Economic Club of New York, as you know, is the nation's leading nonpartisan platform for discussions of social, economic and political issues. More than 1,000 prominent guest speakers have appeared before the Club over the last century and they've established a strong tradition of excellence which, of course, we maintain this evening with our two guest speakers, Secretary Hank Paulson and Secretary Tim Geithner.

I would like to first recognize the 280 members of the Centennial Society, many of whom are seated at the head table and at the front of the room. They support the Centennial Fund, which serves as the financial backbone of the Club. And I'd like to thank them all for their generosity

and steadfast support.

Tonight is also a very special night for the members of the 2018 Class of Fellows. Without exception, each of these individuals engaged fully in the opportunities that this special customized program offers. And I'd like to ask each of the attending members of the 2018 Fellows Class to stand and be recognized. Would you please stand. (Applause) Well done. And as a reminder, I encourage all of you to submit applications for the 2019 Fellows Program. You will find those application forms on the website and I hope that you'll participate in nominating next generation leaders for this special program. I'd like to also welcome students from Baruch's Zicklin School of Business who are with us this evening and I welcome you. I think it's your first participation in the Economic Club and hope that you'll be back often.

And now, of course, I welcome our two honored guests. As I said, Former Treasury Secretaries Hank Paulson and Tim Geithner. As most of you know, Hank Paulson has had an illustrious career as a businessman, as a Cabinet Secretary, as a conservationist, and as an author. He served as the 74th Secretary of the Treasury under President George W. Bush. Prior to that, he had a 32-year career at Goldman Sachs, serving as Chairman and CEO beginning in 1999. Earlier in his career, Hank Paulson was a member of the White House Domestic Council as well as a staff assistant at the Pentagon. Today, he is the Founder and Chairman of the Paulson Institute, which he describes as both a "think and a do" tank, which he founded in 2011. Hank is also co-Chair of the Aspen Institute's Economic Strategy Group. He's a lifelong conservationist. He was

chairman of the Nature Conservancy Board. He founded and co-chaired the organization's Asia Pacific Council and he also founded and chaired the Latin American Conservation Council.

In his book, *On the Brink*, Hank Paulson describes his experience as Treasury Secretary fending off the 2008 financial crisis. His most recent book dealing with China details his career working with scores of China's top political and business leaders. Hank Paulson graduated from Dartmouth College and received an MBA from Harvard University.

Tim Geithner serves as President of Warburg Pincus. He's a member of the firm's Executive Management Committee. Before joining Warburg, Tim served as the 75th Secretary of the Treasury under President Obama. He previously served as President and Chief Executive Officer of the Federal Reserve Bank of New York. He began his U.S. government career with the Treasury Department in 1988. He Chairs the Program on Financial Stability at Yale University School of Management, where he is also a lecturer. He's also Chairman of the Board of Overseers of the International Rescue Committee. He's a member of the Group of Thirty. Mr. Geithner holds a B.A. from Dartmouth College and an M.A. in international economics and East Asian studies from Johns Hopkins School of Advanced International Studies.

We're pleased to have also as our interviewer this evening our fellow Club board member, Becky Quick. And I really think that Becky has the gift of ubiquity. Not only does she appear on Squawk Box where she's a co-anchor, she also is the anchor of the nationally syndicated On the

Money. And I must say she seldom misses an Economic Club meeting and she's always at the other end of the phone when one needs her to do something, to help, and to suggest ideas. So, Becky, thank you so much for doing this this evening.

And the format of this evening will be an on the record conversation. We have media in the back of the room. And following the, or as we prepare for this conversation, we're thrilled to also be able to share a brief clip from the HBO documentary that will be aired next week. So may I invite Hank, Tim, and Becky to come to the front of the room. And as they approach, we will be showing you a film which covers the twists and turns that occurred during the Great Recession through the firsthand perspective that Hank and Tim will be sharing with us directly tonight. Shall we roll...

(Video Clip)

Conversation with Secretary Hank Paulson and Secretary Tim Geithner

BECKY QUICK: Alright, that leaves us at an incredibly interesting point. You're here at another time, it's a very interesting time, but nothing like what we were facing ten years ago. And you all have been doing this a lot this year, on the 10-year anniversary, where you're meeting and re-living and re-thinking all of these things. And I just wonder if you can tell me, has it been a painful experience and what have you taken away from it? Hank, what do you think?

SECRETARY HANK PAULSON: Yes, let me say first, in terms of that Bear Stearns clip, the guy sitting next to me was the one who designed that program and executed it. (Laughter) And the \$30 billion of crapola, it all came back plus a profit. Correct? So, what has it been like? So, I've got to admit that at the beginning, you know, I started finding I was waking up again in the middle of the night. You know my stomach would start churning as you re-lived it. But, you know, it's been, it's been positive for me to be spending time with Ben and Tim again because we formed some very strong bonds that you can only form having gone through that experience. And, by and large, I think it's useful because as Ben Bernanke has said, the enemy is forgetting. And I think it's very important that we not forget and we not have to see another movie like this again sometime in the future.

BECKY QUICK: Tim, what do you think?

SECRETARY TIM GEITHNER: Yes, I would say painful. Painful, but pain mixed with, you know, the power of, you know, we brought our former allies together, 80 people from across the Fed, the Treasury, and the FDIC, to go back and do a bunch of lessons learned, to try to look back at all the choices we made with a little bit of distance, and try to leave a better record to help explain what it takes to save a country from a panic. And our objective was, you know, we wanted to leave our successors frankly with a better set of tools and knowledge than we felt we had going in. So definitely painful but we hope valuable.

BECKY QUICK: I spoke with Josh Bolton tonight at the suggestion of someone here in the audience. And he was the Chief of Staff for President Bush while you all were going through this. He said if there was one question that he could ask you that you all would come in to present to President, you two and Ben Bernanke, and you would speak with one voice. And usually it was Hank who was doing the speaking on this, but even when you were quizzed very directly by the president, do you agree with this, you would agree, you would all sign off. And he wondered how that happened, if you all really had knock-down, drag-outs before you came in, if you all just saw things the same way, or what the back story was? But he said the united front that you always presented was somewhat amazing. What's the answer?

SECRETARY HANK PAULSON: You know, it's fascinating because we had very different backgrounds. We're very different people. Ben was an academic, but he'd studied the Great Depression and he knew that cold. Tim, you know, was sort of a Boy Wonder, in the government, starting as an entry level at Treasury and becoming Under-Secretary of Treasury. And so he'd been through financial crises so he got to really see it for real, you know, around the world. And I'd worked in financial markets. And so we didn't, there were certain things we debated and discussed which was tactics, but we never had to have a really serious difficult debate about the need to save anything we thought was systematically important. Because we all started from the standpoint that if a major financial institution failed, you know, with things as fragile as they were, it would be really bad. And then I think the other thing is we enjoyed working with each other and we were different enough that we really weren't competitive. We

had different skills and we complemented each other.

SECRETARY TIM GEITHNER: Yes, I think we were very lucky in all those ways and we trusted each other. And, you know, trust is a critical element of, a critical requirement for having an honest, open debate about choices. And we were able to debate everything. And we spent hours and hours and hours on the phone every day surrounded by our teams of people, usually on the same phone. A bunch of them are sitting at that table over there. And we were, you know, we were just trying to work through what were the best of those terrible choices. And so by the time we got to the point where we had to act, and you could never wait for a consensus in that kind of moment, but we could get ourselves comfortable that we'd thought through enough of the hard things. And I think we all felt like, we all hoped we were at the terminal point in public life. No aspiration to do anything else. That was sort of liberating too because it was going to be, nothing that we were going to do was going to be, was going to be met with acclaim.

SECRETARY HANK PAULSON: I'll tell you, that point is really important because anyone that was interested in running for political office or cared what the public was going to think was going to be ineffective. You know we had to go back to the same people over and over again. And unless they were stupid, and you didn't want people that were inept, if they were adept and able, they knew that when they worked, you'd say how would you like to work on a rescue program for Citigroup or AIG? So if they were smart, they knew that the best reasonable case was it would succeed and they'd be investigated and criticized and the worst one was they were

on Andrew Mellon's team. And so you had to go back to the same group of people over and over again. And we had terrific people working around us. And I look at some of the people, you know, I had Bob Steele by my side for instance. So it wasn't just the three of us that were connected. We really connected, you know, the Fed and the Treasury – the New York Fed, the Washington Fed, the Treasury and others. So we were really well coordinated.

SECRETARY TIM GEITHNER: Can we just stay on this a little bit more? You know, this was a terrible, tragic thing, what happened. And it's, you know, you can't prevent all crises. You can't design a system that's going to preemptively diffuse them, give people the capacity to foresee them. But there's a whole range of things you can do to limit the damage. And this was a terribly damaging crisis, but in many ways we were a really lucky country because we had, you know, we had tremendous financial strength, a lot of degrees of freedom in terms of what we did once Congress was able to give us the authority we needed. And we had two presidents from different parties at a very dangerous moment, you know, between administrations, who were willing to work together. And they fundamentally put country over party and their short-term political interests. And, you know, I just want to emphasize this over and over again, we had a team of people in these institutions that were masters of their craft and experts in a complicated, messy field. And I say that just to, not just to remind people what the U.S. can do when things are existentially challenging, but to point out the importance of sustaining and preserving a quality of people in these institutions that are vital in any crisis. And if you let that capacity erode, the country will be much more vulnerable. That's necessary but not sufficient. You need a political

system that's, you know, rediscover some capacity to govern, some capacity to act in the long-term issues of the country. And, you know, we need to find some way of restoring some note of grace to our politics that allows people to compromise and come together. So I think part of the value in looking back is not just to honor Ben's reminder about the importance of preserving memory, but also to improve the odds that you can reduce the risk of another crisis like this. And when the next one happens, make sure that we have the critical resources we need in terms of people and capacity to act that is so essential.

BECKY QUICK: Are you saying that because you're worried that that is eroding at this moment?

SECRETARY TIM GEITHNER: In our political system?

BECKY QUICK: Yes.

SECRETARY TIM GEITHNER: Oh, yes, I would say long past eroded. (Laughter)

BECKY QUICK: So, what needs to be done? What are the steps that need to be taken to get back to a point where you feel like we're in better hands?

SECRETARY TIM GEITHNER: I don't know, Hank, you might be more eloquent on this.

(Laughter)

SECRETARY HANK PAULSON: What I would say, I'd say two things. First of all, you know, when we were there, it was a poisonous system too. I mean we had, at the time President Bush was a great leader during the crisis, but you know, 40% in the polls would have seemed very high. He was at 28%. And so we had someone who encouraged me from day one. One of the reasons he had brought me there was he wanted me to work with both sides of the aisle. He encouraged me to build relationships with Democrats as well as Republicans. And fortunately – it would have been really bad if I didn't have a year to build a relationship with President Bush, with Ben and Tim, with members of Congress, to actually get things done – trade deals done, stimulus deals done, other things before the crisis. But as I look at the dysfunction today, I think it starts with, it's really more basic than our political system. We have a polarized country, a very divided country and just the way people get their news. So it's very divided. And I think another one of the basic problems was something that pre-dated the crisis. You know the crisis added to the problems but we had big structural problems before the crisis where we, high levels of, you know, Marie Kravis was reminding me that the first time I made a speech here at the Economic Club, that one of the things I talked about was income disparity way back then. And so it was things like that, income disparity and some of the issues arising from globalization and trade and so on that was already dividing our country even then and contributed to the crisis. And now, you know, it's been accelerated by the crisis, but we still haven't corrected these things. So I think some of the economic issues are feeding into the political issues and vice versa. It's hard to

make a political system work in this country when a big part of the country is being left behind and not participating in that growth. So there's not easy solutions, but I come back to something Tim said. We were really fortunate. Not only was I fortunate to have Ben and Tim – I don't know what would have happened – but to have President Bush and then to have President Obama because we had, this took place right in the middle of an election. And there was policy continuity and so President Bush had to do things that were very unpopular. Obama did things that were very unpopular. So it starts at the top. You really have to have, no way you bring people together unless you have the right leadership at the top. And I think it's going to be increasingly difficult unless we fix some of these long-term structural economic issues. It's a little bit like, you know, a Catch-22. The political system has a hard time working with the economic system that's working the way it is and it's hard to fix the economic system, unless you fix the political system. But I think, you know, I have faith in our country and I think we will ultimately get it right.

BECKY QUICK: Let's talk about lessons learned and where we are now to handle something like this potentially coming up again. Hank, you've said that the reason we got into this trouble to begin with was because the financial structure outgrew the regulatory oversight, and we have made all kinds of changes. But if you look around, are there parts of the financial structure where you look around and say, okay, Wall Street is a pretty creative place, are we getting ahead of the regulatory oversight once again? What do you think?

SECRETARY TIM GEITHNER: I like the way you said it. I think that's true. We allowed the system over a series of decades to outgrow the protections we put in place in the Great Depression. Those defenses that are critical to how stable a system is were allowed to erode. So by early '07, the eve of the crisis, the necessary constraints on risk-taking that we applied to banks, which were too weak, but they only applied to 40% of the American financial system. And that was a critical part of what made the system so fragile and vulnerable to crisis. But the other key thing which was so obvious as the crisis intensified is we came into the crisis without anything like the critical arsenal tools we needed to break a panic and stop a run on the financial system to recapitalize the financial system to give people the incentives to stay, not to run. And those two reasons are the reasons why the crisis was so terribly damaging economically. And after the Great Depression, you know, the country – in its wisdom – did two really important things. Many people forget about the second thing. We put in place a bunch of tougher constraints on risk-taking, more conservative constraints on risk-taking that bought us 70 years of relative calm. But a critical complement to that was deposit insurance for the banking system, was that critical guarantee that is vital to making sure a system is more robust against the risk of panics. After this crisis, we learned, we did half of the lesson. We legislated and put in place a bunch of much tougher constraints on risk-taking applied more broadly across the system – they're not perfectly designed, but they're much more conservative. And they will buy us a margin of safety for a long period to come as long as we don't let them erode. But we didn't really embrace the second key lesson of the Great Depression or this crisis, and we left ourselves with an arsenal of tools to deal with a future crisis that is frankly weaker in many ways than we

had going into the crisis. And I think that's important to remember because the 70 years of relative calm that the post-Depression reforms bought us had both those pieces – better defenses against risk taking, but the essential emergency capacity to limit the risk of runs and panics. And we come out of this crisis with better defenses, but a weaker arsenal against the future crisis.

BECKY QUICK: I mean that's a really important point. There's a couple of things you said that I'd like to go back to. The idea of the tools, because, Hank, you said you did not have the tools, the proper tools to fight a fire, coming out of this. There are weaknesses to that. You couldn't do some of the things today that you did.

SECRETARY HANK PAULSON: Yes, so let's go over them just to be very specific, first of all, what we don't have that we had. I think one of the things we did, which was one of the most effective things we did, and where I was really looking into the abyss if it didn't work, was using the Exchange Stabilization Fund to guarantee the money markets. I mean because the money markets were short-term lenders to all sorts of major industrial companies and we were hearing immediately, when the money markets froze up after Lehman went down, I was hearing from AAA companies that couldn't sell paper. And, you know, if they can't do their short-term funding and can't pay their suppliers, this would spread very quickly. So the guarantee worked like that. But the Congress, even when we got the TARP, they put in, don't you ever do that again, you can never use the Exchange Stabilization Fund unless you go back to Congress. I think that the Fed's emergency lending authorities, they used very creatively, very effectively,

very well on an institution by institution basis. That has been taken away by, you know, by Congress. And I think one of the most effective things was the broad, you know, FDIC guarantee of bank liabilities. That's been taken away. So what we have is we have something we wish we had, which was an Orderly Liquidation Authority, an emergency authority for dealing with failing non-banks. We didn't have that for Lehman. It would have made a big difference if we had. But Tim, Ben, and I are not totally agreed – Tim and I are agreed on this – with the Orderly Liquidation Authority. I think Ben is a little more optimistic than we are that that would work. The presumption of that, the legislative intent is you wouldn't have to use government money, right? And all of us know, to stop a panic it takes government money. Okay. It takes government money. And so we look at the Orderly Liquidation Authority and the living wills and all that, we say that it's great to have them, and if an institution goes down – not in the middle of a panic – if it's a one-off situation, no problem. But in a serious panic or when there's multiple institutions going down, you know, we're not sure how that would work. And the last thing I would say, no matter what the tools are, a lot of it is going to be dependent upon who is sitting in the seat. Because all the flack we got and the unpopularity of the programs when we were there was going to make it harder for whoever is sitting in the seat after us. Tim, is that an accurate summary?

SECRETARY TIM GEITHNER: Yes, I mean I think it's important to recognize that, you know, even these much more conservative defenses that are now in place today in terms of higher capital requirements and more conservative funding requirements, they're not designed to protect against the hundred-year flood. And the ambitions of the architects never would claim that they

themselves work in all states of the world with sufficient protections against a panic in some future extreme shock. Those defenses only work if they're complemented by a set of protections like you have in deposit insurance, other forms of liquidity insurance, and in the extreme case, the ability of the government and the central bank to take risks the market can't take. And, you know, we tend to not want to talk about that because it's uncomfortable. People don't like the feel of the standing capacity for bailouts, but it's essential. And, you know, this is the tragic thing about financial crises is that, you know, they do happen. They don't happen to the same country that often, but they happen with alarming damage and alarming frequency around the world. And there's a lot to be learned from the mistakes countries make in crises and probably the most dominant lesson today is you need both that combination of defenses and emergency capacity. Because, you know, these things are not self-correcting in the extreme case. And, you know, the ideal people have, the hope is that in the extreme moment, if the Fed just lowers interest rates and is willing to lend against collateral, that will be sufficient. And, you know, if you needed a better example of the reality against that, just remember what '07, '08 were like and remember even after the Fed was lending against almost anything to almost anyone, we had a full-blown run, take the system to the edge of the abyss. And it was only when the government was willing to step in, and a huge credit to Hank and Ben and President Bush and the leadership of Congress for making that authority available to provide capital and guarantees and take out the extreme risk in that context. And, you know, again, the time to think about these things are when things feel better, they're more stable, the sun is shining. If you wait until the moment where the crisis is upon you, you might think it makes it easier for people to act, but it's hard to act in that

moment because the instinct of the normal human is to say let's not do that yet. And if you run a system like we're doing today, the country will be late because Congress will be reluctant to act again until the fear and the panic and the economic damage on the hundreds or millions of innocent Americans is so powerful that they have no choice but to act. But if you run a system where you have to wait for them to be mobilized by the evidence of catastrophic damage, you're doing, I think, grave damage to the fabric of our economies and, you know, you'll live with the aftershocks in terms of the political damage for decades after that.

SECRETARY HANK PAULSON: And that last point is so critically important because it just was so obvious to all of us. It took a crisis to get Congress to act. And there's no worse feeling than feeling a great sense of responsibility and not having the authority you need. And we had a crash of politics and markets, and as I say, when that happens, markets always win. So there was a delay. It was we knew we needed the authorities, but even after, you know, in the darkest days, Congress voted the TARP down the first time. It took the market crashing to get them to vote it in the second time. And we're now in a situation where Congress has said we're taking away these authorities. You had too many authorities. Not only are we not giving you many additional ones, you used some creative things we didn't think you had. And so you made up some stuff that we wish you hadn't and so we're going to pull it back and we want you to have to come to us and get that again.

BECKY QUICK: So the next regulators will have to out-innovate just like Wall Street does.

SECRETARY TIM GEITHNER: You made a good point when we started this in the sense that, you know, the natural forces of markets will find their way around the best defenses. It's just inevitable. And again it took 70 years after the Great Depression for the banking system to shrink to a relatively small share of the system and all that risk to move outside the banking system. That will happen again. You want to be careful, therefore, not to allow the system to fall too far behind the curve. You want to make sure you're leaning a little more aggressively against the natural tendency of risk to find its way around those constraints.

BECKY QUICK: Are there places you think that's happening right now? Non-bank lending institutions?

SECRETARY HANK PAULSON: I was going to say one thing, which is a point I make which is, people sort of laugh the first time they hear it. But bad ideas don't get you in trouble, it's good ideas, and you can have too much of any good idea.

SECRETARY TIM GEITHNER: There were some bad ideas too. (Laughter)

SECRETARY HANK PAULSON: There were some very bad ideas. That's right, some bad ideas, and you can have too much of a bad idea. But, you know, securitization is not a bad idea. Money market funds are not a bad idea. There's been a lot of, the repo market is not a bad idea. And so now, as I look at some of the, you know, the online internet banking, you know, in China

and other places, and I look at what it does in terms of giving credit to a lot of people and helping move people out of poverty and so on, you just need to remember, and to make the point, as Tim said very elegantly, you know at the time the financial crisis had, over 50% of their credit was fully outside of the banking system. And I think we focus on where the last war was fought. And everybody's looking at the big banks, why are we breaking them up? Why are we being tougher on the banks? The banks are better regulated. And to the extent we are tougher on them, we drive the risk out to all kinds of other places. And the risk, you know, it doesn't necessarily have to be in the big banks to bring a system down. And that's, I think, one thing we need to be careful about. I don't think any of us want to speculate and say, you know, this is where the problem is. Because at least I believe no one, I believe these things are unpredictable as to timing and severity. I really believe that. It's just not an excuse. Someone always predicts it and then they say I guessed it, I predicted it, I knew it. But they won't get it the next time. And so it's unknowable. The thing you know is you're ultimately going to have a crisis. And the best you can hope for is to get it before the bubble becomes too great and to have the authorities you need so you can move quickly to put out the fire before it becomes a panic.

BECKY QUICK: Let me just throw out a couple of areas again, in non-bank lending or different areas. People look at corporate debt. Is that swelling up to a point that it concerns you if you get back to the levels of 2007 or anything? Or is this a different beast this time?

SECRETARY TIM GEITHNER: I'm not sure this is the best way to think about this, but I think

it helps. I think, you know, the severity of crises are a function of a bunch of different things. It partly is what's the scale of the imbalances, the underlying economy, you know, how large was the boom in borrowing, how was that, what did that borrowing finance? How sensibly was that capital allocated? The second thing is how strong is the financial system itself? How resilient is it? And the third has a lot to do with the capacity of policy to act to offset the effects of a major shock? And I think if you look at the U.S. today, again we're still in an enviable position relative to much of the world. You know there's always imbalances in our economy, but I think fundamentally they're relatively modest in severity relative to, certainly to '07. They seem that way today. Household balance sheets are much stronger. The financial sector, you know, we learning something, we'll learn something about how robust it is when we face the next downturn. But by really almost any measure that we know as valuable, it's a more stable system. But the Keynesian arsenal, the capacity of the Fed to lower rates aggressively off the downturn is more limited today than it was in '07. You know typically the Fed eases by 300 to 500 basis points in a modest recession even. You don't have that room yet and it's going to take a while to rebuild that room. And the fiscal arsenal of the country has eroded too. So apart from the emergency tools, which are somewhat weaker on net, you've got a slightly less unstable economy, a significantly more stable financial system, but a slightly weaker set of policy tools to offset the shock. So it's, I would say – just to be fair – it's a mixed picture. And, you know, it's always good for people to be, you know, worried about and attentive to what happens when things fall apart. You know you only have, you only have the dangerous kind of booms when people are certain crises will never happen. And people, the risk aversion that came after the

crisis is still with us. There's still a lot of memory about the trauma of that period and you see that's still affecting some parts of behavior. And, you know, maybe that will buy us a little bit more comfort too in the next crisis.

SECRETARY HANK PAULSON: Another thing we can't forget, the world, I think, is getting smaller and smaller and more interconnected. And so I think being able to play a role in shaping global policies that promote peace and financial stability and economic stability and so on are important. And when I look at risk, you know, I'm more focused on outside of the U.S. And I'm not predicting any of this but, you know, a major problem in Italy or, you know, somewhere in Asia, or so on, we're all very interconnected. And one thing that I've learned and I learned it, you know, the first time when I was at Goldman Sachs and I looked at when Russia blew up. Remember the default in '98. And I remember sitting there and being sort of naive and thinking, well, thank goodness we didn't have any exposure to Russia. You know, weren't we smart? And, of course, what happened at that time, as you'll recall, First Boston was big in Russia, right? And so they had losses and we couldn't understand why are there suddenly all these losses in the commercial mortgages? And, of course, they were unloading all their commercial mortgages. And pretty soon it went from asset class to asset class and we're all sitting around the same risk table thinking we had these unique positions and all the buyers were in the hospital. And it seemed like a very serious problem then. Well, it was very different than what we went through in '08. So it's very hard, you know, there's tertiary, secondary, tertiary effects. And so it's very hard to sit there and say we're isolated, it's not going to impact us. That's why Tim's first two

points were really the important ones. Is our economy strong and resilient? Do we maintain our competitiveness, you know, in the U.S. and with the rest of the world? Do we maintain our fiscal strength? That is very important. And do we have resilient institutions that are well capitalized? Because ultimately that's the best defense. And the thing that shocked me going through the crisis, as much as anything, was how certain financial institutions didn't understand liquidity. You'd call them up and say how much liquidity do you have? And they'd say, oh, we've got two weeks or three weeks. And what they meant was if everybody started behaving like they had behaved during normal times, we'd have that. And so having that, and then having the policy tools to react. Because otherwise I think it's very hard to predict when there will be a crisis and how severe it will be.

BECKY QUICK: One thing that is happening in the markets right now, though, is all of these worries that are coming to the forefront – the yield curve, if you're looking at five years versus threes and twos, and inverting this week for the first time since 2007, the markets are very volatile and selling off over the last couple of months, up and down. People are looking at all kinds of things. Is this a reflection of a slowdown in global growth? Is this a reflection of concerns from CEOs maybe based on trade and tariffs or things along those lines? At the top of your worry list, what would you put? And what you look at?

SECRETARY HANK PAULSON: To me, I'm going to just repeat what I've been saying. There's always going to be volatility in the markets. There's always going to be risk. So the top

of mine for me is fixing the problems we have while we're strong. Fixing our, you know, we've got less economic problems than any other major economy, but we've got to do something about the fiscal challenges. We're ultimately going to have to fix them. And the longer we wait, the more painful that's going to be. I come back to this income disparity. I mean I'm looking, you know, I'm very, when I look at what the Obama administration did after we left, when I look at what the Fed did, it was pretty amazing that this economy has been growing at 2% and deleveraging since the third quarter of 2009. So the top line growth and where we are today in job creation is all great. That's the time to restore, you know make sure we're maintaining our economic competitiveness and strength and that we're working to repair our political system and have that be more functional. To me, that's the number one thing. Otherwise, I'm not going to point to one risk versus another because there are plenty of risks. And I don't know what's going to hit us, but I know sometime over the next 10 or 15 years there'll be another crisis. Now, hopefully, it'll be 75 years before we have another, you know, flood like we have. But we know it's coming and as long as you have financial systems, banking systems, and political systems, you're going to get dysfunctional economic policies that are going to lead to excesses and bubbles. They're going to manifest themselves in the financial system no matter how it's structured. And you're going to have crises. The banks will get all the blame. They'll deserve a lot of it, but a lot of it also goes to the politicians that created this and there'll be crises. So that's why we're doing what we're doing is I really do think we need to remind people that there are these risks out there and there's a risk to not ensuring that the policymakers have the tools to deal with a severe crisis.

BECKY QUICK: Let me add one more to the list of concerns of lessons that might be taken away. I think about the bank CEOs, you saw Jamie talking about the Bear Stearns purchase. What happened after you all left, or beyond your control in a lot of circumstances? There were tens of billions of dollars in fines that were punitive fines that were put upon a lot of these banks. Jamie and others have said that they would never do it again. Is that a lesson that future CEOs take away and say we're not going to do an emergency purchase where we step in and do something we want, but also something that we think is helping the government?

SECRETARY HANK PAULSON: I would simply say I wasn't there and didn't make those decisions.

BECKY QUICK: That was out of your control.

SECRETARY HANK PAULSON: And I know Tim didn't. It was the Justice Department and so on. I think it was an ugly part of our history. I think it was wrong. That's my view. I think they stepped up and you know, to step up and take Bear Stearns, Jamie wanted to buy Bear Stearns. He wanted to buy it and it helped them. And I think WaMu, I don't know what the story was with WaMu, but that was also a very important acquisition, and I think it'll be harder in the future. And I don't know what they agreed to or what they didn't agree to, but I think, you know, the regulators were very, the legal system was very tough on JP Morgan, and I think unfairly so. But again I'm unburdened with all of the details and the facts. I just simply know that if he had

said to me I want to be protected, I would have said you're protected. And he probably wouldn't have been.

SECRETARY TIM GEITHNER: I don't think you could have offered that protection.

SECRETARY HANK PAULSON: What?

SECRETARY TIM GEITHNER: I don't think you could have legally offered that protection.

SECRETARY HANK PAULSON: I couldn't have. I couldn't have.

BECKY QUICK: Tim, what do you think about that?

SECRETARY TIM GEITHNER: Yes, I mean I would say that's the established conventional cautionary view. I mean it's important to recognize that even under the best of circumstances, even if that had not been true, you couldn't run an effective strategy in a crisis like this by expecting the market to absorb all the risk. It was out there. It was not going to happen. You know in the extreme tale, everybody's at fragile risk of collapse. And you know the only defense against that, the only way to protect the economy from that is for the government and the central bank to take out the catastrophic risk. So you can't, in the extreme crisis, just hope to shift it around a little bit and sense some acquisitions by the relatively strong or relatively weak. You

know you should do that to the extent you can, and we did that relatively creatively, but there are limits to that.

SECRETARY HANK PAULSON: We did it because we were forced to do it and you're right. And ultimately at the end of the day it was going to take government money. So ultimately at the end of the day we were, no matter how many rescues we pulled off, we weren't going to be able to put out the fire without government money. And the fire had to be burning pretty hot to get Congress to act.

SECRETARY TIM GEITHNER: Yes, I want to say just one piece of this, just because we're wallowing in history. You know most of us, President Bush said it on the screen, you know most normal people – and I would say this is true across the political spectrum – find the idea that the government or the central banks should step in and take a bunch of risk, they find the idea morally offensive and repellant. And their sense is there's something fundamentally unjust about it and it's avoidable. And there's a lot of rational human nature in that, but it mis-perceives the core thing about the way financial systems work. And it mis-perceives what is the nature of what that assistance does. And, you know, you should think about what we did, as a country collectively, a little bit more like the way deposit insurance and the FDIC works in some sense, which is that we provided a bunch of protection to the financial system, not for their benefit, but to prevent a Great Depression. And they paid for the protection and the taxpayer earned – because we designed it relatively well in the end – directly hundreds of billions of dollars on that

protection. It was not a grant of taxpayer resources that went away and was dissipated on compensation. They got a direct financial return, remarkably rare in history. No history of a major economy in a financial crisis that has not lost 5 to 10% of GDP on the financial rescue. We earned a substantial positive return. That's not the best measure of whether the system was designed right because it would have been sensible economically to take a lot of risk even if you lost a lot of money. The economic return was much greater than that. But it is a key thing about understanding about this, and it's a key to the politics of the challenge in some sense because the way these things are described, it's as if these are resources dissipated, never seen, come at the expense of education, Medicare, aid for firemen and teachers. It's just, it's an understandable misconception. It's not that you should welcome the use of it, but you should recognize that sometimes it's necessary. And if you design it carefully and effectively, you can – in effect – have the system pay for the protection the government provided.

BECKY QUICK: I'll ask you finally a question for each of you. Ten years later, looking at where we are now, what surprises you the most about where we have wound up, both a positive surprise and a negative one. Who wants to take that first?

SECRETARY HANK PAULSON: Well, I would say that, I wouldn't say it's a positive surprise, but it is a positive development that – and I'm repeating myself – but that the economy was growing at 2% a year from the third quarter of 2009, and that the money we put out came back. And I'm not saying it was a shock. And, you know, on the negative side, and I look back, and

now I look back and I just feel great gratitude for the way, the teamwork and, you know, we really saw the very, very best of our government. We saw the worst, you know, leading up to the crisis. So we saw the worst and then we saw the very best, and the way people worked together. You know, as I look back on it, that's a surprise. On the negative side, I've got to say to you, it's not the hugest thing in the world, but the idea that Fannie or Freddie hasn't been, hasn't been, they're still in conservatorship, still in their present form. And that we haven't done more to fix some of these festering economic issues that pre-dated the crisis, contributed to the crisis, and are still going on. And I'd say the other thing that has surprised me, now it just seems obvious to people, but it surprised all of us that worked on this and the press that covered it at the time, they said not that these are going to be unpopular, but how incredibly unpopular our actions were. You know, I looked at, when I left, Ben and Tim were still there. To me it was just an incredibly exhausting period that went on for a year and a half. And I left and it was still going on. But when I left, I looked at a poll and the way I read it, the things we did were more unpopular than torture. (Laughter) And I've got to tell you, that surprised me. I knew they were unpopular, but really unpopular.

BECKY QUICK: Wow! Waterboarding...

SECRETARY TIM GEITHNER: No positive surprises. All negative surprises I would say. And mostly about what's happened to the political system. I mean I think it's important still to recognize that, you know, we are still such a lucky country and I don't think we should trade our

challenges for anyone else's. But, you know, we have some major challenges politically and economically. And we have a political system that's looking less able to deal effectively with those challenges. And that's not something, we can survive that for a time, but we can't survive it indefinitely. So, you know, you caught me at a somewhat dark moment.

BECKY QUICK: Just to end on a slightly better note, who has to be charged with fixing it? Whose responsibility is that? And it's a message you want everybody here to hear...

SECRETARY TIM GEITHNER: You know the people of the country have to decide they want more confidence again. They want to restore some measure of grace and compromise to people who serve in public office and they have to expect it of them, raise their expectations.

SECRETARY HANK PAULSON: It ultimately comes to the American people. You get the government you deserve. But I do think, you know, you can get yourself pretty negative just looking at how divided our country is. And, you know, whenever I start – and Wendy says I sound like a grumpy, old man, I should be careful – but when I, you know, I talk to someone who is a friend of yours, like Warren Buffett, and he reminds me with a longer term perspective, don't vote against, bet against the United States of America. And if you want to be optimistic, spend some time on some campuses with the younger people and the energy and so on. So, you know, I'm longer term optimistic. I really am. But right now it's, you know, we need to fix some things.

BECKY QUICK: Secretary Paulson, Secretary Geithner, I want to thank you both for your time tonight. Thank you. (Applause)

CHAIRMAN MARIE-JOSEE KRAVIS: Thank you, Hank, Tim, and Becky, for a very candid and timely conversation and for sharing your insights with us. And we look forward to viewing the documentary, the full documentary next week on HBO. I wanted to thank all our members and guests who are with us this evening for our closing dinner of the year. And we begin the year with Jamie Dimon, so we will continue this conversation and look at the future. Jamie Dimon will be with us on January 16. And then he will be followed by John Williams, the new Chairman and CEO of the New York Fed on March 6. So, the year 2019 promises to be quite exciting. And I thank you all, wish you happy holidays and enjoy your dinner. Thank you. (Applause)