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Bolten's White House

BY FRED BARNES

And why Hank Paulson, the former Goldman Sachs chief, is the new Treasury Secretary.

The man who will shape President Bush's economic policy in his final two years in the White House—and particularly America's policy toward China—almost didn't join the Administration. Hank Paulson became Treasury Secretary last July only after prolonged negotiations over his role as chief economic policymaker. To lure Paulson to Washington, the President gave him extraordinary authority to manage economic policy on both the domestic and international fronts. Paulson, from the outset of his tenure, matches Secretary of State Condoleezza Rice and Defense Secretary Donald Rumsfeld as a Cabinet member with the discretion to act on his own without White House interference.

Last spring, Paulson, then head of Goldman Sachs, the giant investment banking firm, rejected an offer to become the top finance minister. He declined to meet with Bush, fearing it would be impossible to turn down a personal request by the President. His family was leery of his coming to Washington. And Paulson had doubts that Bush would have enough political clout left in his Administration to promote a significant agenda in 2007 and 2008.

But Josh Bolten, the White House chief of staff who worked for Goldman Sachs before joining the Bush presidential campaign in 1999, kept after Paulson—and changed his mind. Bolten worked out an arrangement that gives Paulson enormous influence, far more than was given to the two previous

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Chats With Rubin

U.S. Treasury Secretary **Hank Paulson** takes exception to the popular notion that China's rapid economic ascent will continue unimpeded.

On entitlements, there is a sense among members of Paulson's team at Treasury that they may be able to succeed where Bush failed. Paulson talks regularly with **Bob Rubin,** President Clinton's Treasury Secretary, who is influential with Democrats on domestic and economic policy.

—F. Barnes

Treasury Secretaries in the Bush administration, Paul O'Neill and John Snow. The official portfolio for the post "is not really all that large in the modern age," Bolten said. But Paulson's power will extend "well beyond that portfolio."

In fact, Paulson's emergence represents a major shift in economic policymaking from the White House to Treasury. The losers are Vice President Cheney, National Economic Council head Al Hubbard, and the President's Council of Economic Advisers chaired by Ed Lazear. Their clout has been significantly diminished. The only winner at the White House is Bolten, who also was the key figure in the appointment of Ben Bernanke to be chairman of the Federal Reserve.

But while Bolten was the architect of the shift, Paulson is now the master of economic policy. "He didn't want to be hemmed in by a bunch of White House handlers," Bolten said. And he isn't. Paulson was allowed to hire whomever he wanted. He has brought in several Goldman Sachs veterans from around the country as senior advisers, including Bob Steel from New York as Undersecretary for Domestic Finance and Neel Kashkari from San Francisco as counselor.

By bringing a team of personal advisers from Goldman Sachs, Paulson's style is reminiscent of James A. Baker's. Baker was Treasury Secretary in Ronald Reagan's second term. He relied on three aides—Richard Darman, John Rogers, and Margaret Tutwiler—that he'd brought with him from the White House, where Baker had been chief of staff. He insulated himself from Treasury's permanent bureaucracy and leftovers from the staff of the prior secretary. Paulson may be doing the same.

Paulson's portfolio is bulging with issues that once were in the bailiwick of other Bush officials. China, for instance. He's the lead figure in economic talks with China. Both Bush and Rice have given their blessing to that. Paulson, Bolten said, will have "a much more prominent role in overall relations with China." This was underscored by Paulson's three-day trip to China in September in which he established a

Chats With the President

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The Losers

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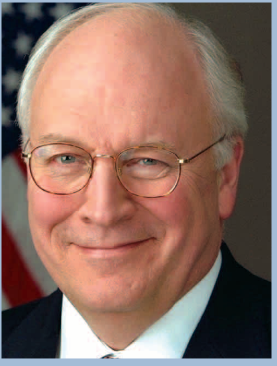

Dick Cheney

Ed Lazear

Al Hubbard

U.S.-China Strategic Economic Dialogue. Even more important was his unprecedented meeting with Chinese President Hu Jintao. It was the first time a U.S. Treasury Secretary had met with a Chinese President for such a substantive meeting.

Unlike members of Congress, Paulson is more worried about the possibility of an economic stumble in China whose ripple effects would quickly reach the United States than he is about Chinese manipulation of its currency to promote exports and limit imports. During a press conference in Beijing, he expressed patience with China's unwillingness to revalue its currency. "That isn't achievable right away," he said. "I'm looking at something short of the perfect outcome, which is a freely tradable currency. I'm not going to get all concerned about what technique they use to get flexibility. I'm going to know flexibility when I see it." In short, Paulson won't be aggressively pressuring China to devalue for the time being.

Paulson takes exception to the popular notion that China's rapid economic ascent will continue unimpeded. In a speech on the eve of his trip to China, he said China's future growth should not be extrapolated "from its past performance, as if China has somehow found a way to immunize itself from business cycles and all other economic problems." His concern is not that China will overtake the United States economically but that Chinese leaders "won't move ahead with reforms to sustain its growth." That's a polite explanation for what might cause an economic slowdown, or worse, in China. And "because it is a global leader, what happens in China will affect the well-being of the United States and the rest of the world."

Paulson's fear of a significant Chinese recession dovetails with another of the major tasks assigned him by Bush: crisis management. Paulson believes

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a financial crisis is overdue—a serious crisis that would be a body blow to the U.S. economy. This fear is shared, to some extent at least, by Bush and Bolten, who wanted a major Wall Street player at Treasury in case an economic emergency occurs.

To prepare for a crisis, Paulson has activated a financial working group whose key members are the Fed's Bernanke, Securities and Exchange Commission head Chris Cox, NEC director Hubbard, and Reuben Jeffrey of the Commodity Futures Trading Commission. Paulson is in charge and has assigned Emil Henry, Assistant Treasury Secretary for Financial Institutions, as the hands-on director of the group.

Still another part of Paulson's portfolio is trade. He is expected to exert a greater influence on this issue, especially in combating strong protectionist sentiment on Capitol Hill, than either of his predecessors.

Within days of returning from China, Paulson met privately with two senators, Democrat Chuck Schumer (NY) and Republican Lindsey Graham (SC), who had threatened to put a 27.5 percent tariff on Chinese imports to force China to float its currency. Paulson, who believes open markets invariably produce prosperity, favors a soft approach to dealing with congressional protectionists. While in China, he had kind words for Schumer and Graham. "They are knowledgeable about China," Paulson told reporters in China. "They share many objectives that I share. I don't agree with the tactics." Paulson persuaded them to back off from pushing their tariff legislation to a vote. His argument was that he had established a "dialogue" with the Chinese and needed time to convince them to move toward serious devaluation of their currency. Besides, tariff legislation now would only alienate the Chinese, not prompt them toward compromise.

Tax cuts and tax reform, by the way, are not on the Paulson (or Bush) agenda.

It was Paulson's seventy-first visit to China and he was advised on the trip by a mystery figure who helped set up meetings with important Chinese officials. The adviser was Deborah Lehr, a former official in the U.S. Trade Representative's office who most recently worked for Stonebridge China, a consulting firm, where she runs the China practice. Her firm has offices in Shanghai and Beijing and represents both American and Chinese companies. She has extensive ties with Chinese officials. Lehr also happens to the wife of John Rogers, who was Paulson's chief of staff at Goldman Sachs. Paulson brought Lehr to Treasury as his special adviser on China. Her sudden resignation for personal reasons just weeks after the China trip left observers somewhat baffled, and created some uncertainty over Treasury's leadership on the China issue.

Besides thwarting protectionism, Paulson has the task of reviving Bush's entitlement reform initiative. The president has convinced Paulson he wants to go ahead, regardless of whether Democrats capture the House or Senate in the midterm election. Bush, of course, failed miserably in 2005 when he proposed (and pushed vigorously for) reform of the Social Security program.

This time, the Paulson-led effort may concentrate more on reforming Medicare and Medicaid than Social Security. Bolten thinks "stars have aligned in a way" to make the first six months of 2007 a time when Republicans and Democrats may be open to compromise on overhauling costly entitlements. "The president is prepared for Paulson to lead the charge through that opening," Bolten said. Even if nothing is enacted, the effort could "tee up this president's successor to be in a

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The Amigos

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On entitlements, there is a sense among members of Paulson's team at Treasury that they may be able to succeed where Bush failed. Paulson doesn't carry Bush's political baggage and is more willing to make concessions to achieve a compromise. Besides, he talks regularly with Bob Rubin, President Clinton's Treasury Secretary, who is influential with Democrats on domestic and economic policy.

Where Paulson may not have much leeway is tax policy. Inside the Bush Administration, it's known that he's not opposed to raising the top rate on individual income as part of a deficit reduction package. But he would have a difficult time getting the president to go along, since a tax hike would anger conservatives and split congressional Republicans. But raising taxes as part of Social Security reform is another story. When he campaigned in 2005 for modernizing Social Security, Bush himself was open to raising the level of income subject to payroll taxation.

To handle his huge agenda, Paulson's chief of staff, Jim Wilkinson, is working to create a policy planning staff at Treasury much like the one at the State Department. It would take over at least some of the policy development function of the White House. Wilkinson, by the way, was hired away from Secretary of State Rice, where he was a senior adviser, after briefing Paulson on the transition to his takeover of Treasury. Wilkinson earlier worked in the White House.

Bolten is frank about why he and Bush wooed Paulson and why the President was willing to give Paulson a large measure of independence. "He comes with the advantage of extra credibility in the financial markets," Bolten said. "He has star power. He has energy. He has familiarity with the international scene."

Bush fired his first Treasury chief, Paul O'Neill, who wasn't in sync with the President's agenda. O'Neill's successor, John Snow, was an effective salesman of Bush's policies, but he lacked clout in Congress or on Wall Street. For the final years of his presidency, Bush wanted a big name, a major financial leader, what Bolten calls "a big figure." Paulson fits the role perfectly, which is why the White House tried so hard and so long to get him. And is so happy he's on board. ◆