chanson d'automne

par Eric Baudelaire

Septembre 2008. Les pages du *Wall Street Journal* égrènent les mêmes informations: faillites des banques, chute du Dow Jones, etc. Au même moment, Eric Baudelaire propose de lire dans ces pages une tout autre chanson. Les vers de Verlaine qu'il découvre dans le journal furent diffusés en code en 1944 sur la BBC: «Les sanglots longs / Des violons / De l'automne» pour signaler l'imminence du débarquement; «Blessent mon cœur / D'une langueur / Monotone» pour déclencher des actes de sabotage. Cette œuvre, ici recomposée par l'artiste, effectue le geste même de la fiction, fait surgir d'autres textes à même les textes, et laisser entrevoir, rêveusement, d'autres possibles.

THE WALL STREET JOURNAL. Thursday, September 25, 2008 A19

OPINION

The First Debate Could Be Decisive

By Karl Rove

Presidential debates are important—and the first debate is the most important of all, establishing an arc of opinion that persists unless jarred loose by big mistakes or dramatic events.

So whether this year's first presidential debate between Sens. Barack Obama and John McCain is Friday night or postponed a few days, it may be the fall's most critical event. In the nine first debates since 1960, the perceived winner of the debate averaged a 4.2 point net swing in the Gallup poll.

Mr. Obama fought hard to have the first clash devoted to foreign policy and the last on the economy. It may be smart to end the series on his strongest turf. But that means the debates start on ground where Mr. McCain is more comfortable, having a sizable poll lead on who'd be a better commander in chief.

Here's the advice some experts I consulted offered the candidates:

First, do no harm. Persistent proficiency is better than big mistakes. Remember Al Gore's sighs in 2000? President George H.W. Bush glancing at his watch in 1992? Michael Dukakis's botched answer to Bernie Shaw's death-penalty question in 1988?

Know what you want to achieve and have that narrative down cold, for yourself and for your opponent. How do you want potential defectors and converts to see and feel [illegible] you and your opponent when [illegible]'s over? How do you [illegible]te your strengths and his weaknesses?

Answer the questions. Voters don't like it when candidates are not responsive. Mr. McCain shone so much brighter at Rev. Rick Warren's Saddleback conversation because he answered with plain talk and simple declarative statements.

People want to [illegible] candidates operating withou[illegible] a [illegible]cript. They are clamoring for [illegible]ntaneity. So avoid hyper-repetition. For example, Mr. Gore's repeated robotic invocation of the phrase "risky scheme" backfired.

Spend time describing problems. In the '92 debates, Bill Clinton and Ross Perot established personal links with voters as much from how they portrayed the nation's challenges as from their proposals to address them.

Humor is a powerful weapon, but only if it is not canned or forced. Ronald Reagan demolished Walter Mondale with this self-deprecating line: "I want you to know that also I will not make age an issue of this campaign. I am not going to exploit, for political purposes, my opponent's youth and inexperience."

The counterpunch is better than the punch. The first person to attack generally suffers, especially if the attack comes across as exaggerated or unfair. Attack sparingly and then by inference and obliquely. Rather than a frontal assault on Mr. Obama's inexperience, Mr. McCain could say America's adversaries will test any new president, and only he has the skill and leadership the country will need in that crisis.

Mr. McCain needs to come across as optimistic, loose and likable. He must guard against revealing his lack of respect for Mr. Obama. And he must grab the "change" banner from Mr. Obama by describing a few things he'll do internationally that are new and different.

Mr. McCain should remind voters the surge in Iraq was the most vital decision in the War on Terror. Mr. Obama opposed it and even continued to oppose it after it was an undeniable success. And Mr. McCain should

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A10 *Saturday/Sunday, September 6 - 7, 2008*

OP

REVIEW & OUTLOOK

The Jobless Jump

Friday's jobs report for August was dismal by any measure, with payrolls falling by 84,000, and another 58,000 jobs lost in downward revisions for June and July. Private sector job losses were even higher at 101,000 for the month, and overall job losses for 2008 now stand at about 600,000.

So much for that rebate 'stimulus.'

The cries of recession are naturally back in four-part political harmony, though those predictions have been wrong so far. We've been hearing that the economy is "already in recession" for at least a year, but there's only been one quarter of negative growth—a reduction in GDP of 0.2% in the fourth quarter of 2007. The economy has been growing since, albeit too modestly to keep anyone happy.

The August job losses also need to be put into the context of the eight million new jobs created after the Bush tax cuts passed in May 2003 through 2007. At 6.1%, the jobless rate climbed from 5.7%, thanks in part to a surge in the size of the labor force and an expansion of federal jobless benefits. In September of 1996, when Bill Clinton was running for re-election, the jobless rate wasn't much lower at 5.5%.

If you're looking for silver linings, such as they are, average hourly earnings are still rising and have climbed at a 4.3% annual rate in the last quarter. Productivity growth has also been stronger than expected, which paradoxically hurts job creation as cautious companies squeeze out more efficiencies rather than add labor costs. The percentage of private companies adding jobs also popped up—to 48.9%—which is the highest in many months. So the economy seems to be muddling along, rather than slipping into recession. Given the magnitude of both the housing slump and the credit writeoffs on Wall Street, the fact that the U.S. economy has avoided a downturn so far can only be called remarkable.

The bad news is that there isn't much reason for businesses to start taking more risks. The credit crunch is continuing, amid uncer-

tainty over the banking system and housi
market. The Treasury's plan for a taxpay
backstop of Fannie Mae and Freddie Mac w
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down as another Beltway triumph.
Political uncertainty is also a negati
with the policy risks for 2009 still unknow
A Democratic sweep in November all b
guarantees a huge tax increase, which wo
restore animal spirits. Meanwhile, the jo
less numbers will likely cause the Federal R
serve to maintain negative real interest ra
even longer than it already has. This mea
greater risk of future inflation, and with it f
ther declines in real incomes.
Amid this news, we couldn't help but n
tice yesterday's White House press relea
declaring that "the bipartisan econom
growth package that President Bush sign
into law is having its intended effect." The a
gument is that the economy would be wor
were it not for the $150 billion in tax reba
checks. Thanks for the very small favor. T
checks goosed consumer spending for a fe
months but without any permanent chan
to the incentives to work or invest.
As a political matter, any rebate impact
[illegible] off just as the fall election campai
begins[illegible]ost voters want to know where t
[illegible]y is headed now, rather than that
could have been worse in the summer. Yeste
day, Barack Obama was naturally blaming R
publicans for the job losses, even though t
failed "stimulus" was also his idea. He ev
wants to do it all over again.
Memo to Republicans: This is what ha
pens when you settle for political stimul
gimmicks rather than tax cuts that are imm
diate, permanent and at the margin. Memo
John McCain: You'll need a better argume
than "these are tough times" and "I'll fig
for your future."

Travel | Laura Landro on the Hamptons' other season | **W6**

THE WALL STREET JOURNAL. Saturday/Sunday, Septembe

A Hope fo
Americ

A16 *Thursday, September 11, 2008*

Exports Bolster I

Continued from the front page
positive manner, virtually every industry and every state," says Daniel J. Meckstroth, an economist at the Manufacturers Alliance/MAPI, an Arlington, Va.-based public-policy and research group that represents mostly large manufacturers.

Foreign buyers are scouring the U.S. for everything from guitar strings and wine corks to used dump trucks and newsprint. The volume is so great that some inland trade hubs can't find enough metal shipping containers to load products headed overseas.

Dramatic Shift

Export-driven growth marks a dramatic shift in an economy that has relied heavily on consumer spending. That has slowed in recent months as Americans, nervous about job losses, teetering banks, falling home values, and rising gasoline and food prices, have tightened spending. Against that background, exports have emerged as a powerful motor.

Over the past year, real-goods exports have risen $115 billion, or 12%, and are up across every major category. They now make up nearly 13.5% of gross domestic product, the highest percentage since World War II. Critics often grumble that the U.S. exports masses of scrap steel and other waste materials to recyclers in China and elsewhere, which is true, but exports of manufactured goods, commodities and services are also growing. Consumer products, from sporting goods to art supplies, have risen 12%, and even autos, which are languishing on showroom floors in the U.S., saw a 4% bump up in exports.

Service exports—which include media, entertainment, financial services, computer software and foreign tourism in the U.S.—have grown strongly right along with the larger goods side of the trade ledger. Through the second quarter of 2008, real service exports are up nearly 10% over the past year.

It's a badly needed tonic for the beleaguered U.S. economy. A smaller trade gap, due to growing exports and slowing imports, combined to add 3.1 percentage points to the GDP's growth rate in the second quarter. The latest report from the Institute for Supply Management also showed that while manufacturing as a whole shrank slightly in August, the index for export orders, an indicator of future export business, rose to 57 from 54. ISM readings above 50 indicate expansion.

Key to this growth has been the weaker dollar, which has made American goods more competitive in global markets and prompted many manufacturers to expand production inside the U.S.

Consider what's been happening at D'Addario & Co., a Farmingdale, N.Y., maker of guitar and violin strings. A set of the company's violin strings sold for about £22.50 ($39.55) in England two years ago, which made them slightly more expensive than those of their key competitor, which was selling strings at £21. But thanks to the decline of the dollar since then, the same set of D'Addario strings sells for about £24 today, while the competitor is now £27.

"Our competitors in the [violin-string] business are all European," says James D'Addario, the company's chief executive. "With the cost of the euro, they've just become far more expensive in every market, including the U.S." And China, as well: D'Addario's sales of violin strings there are up nearly 400% this year.

The company, which had $115 million in revenue last year, says it is making more than 550,000 strings a day at its Farmingdale plant, up from about 400,000 18 months ago. A large chunk of this is flowing to guitar manufacturers in Asia, a segment of D'Addario's overall business that's up 40% this year. Even though the company has cut the time for making strings through automation, it has had to add about 60 people to the production staff since last summer to keep up with the growth.

Dollar Edges Up

The dollar has recently begun edging back up against key currencies, but it remains far below the levels it hit earlier in this decade, when a strong dollar was widely blamed for suppressing U.S. exports.

"It's getting increasingly likely that the pace of growth will slow, but to say the boom is over is too strong," says Nigel Gault, an economist at Global Insight, an economic-forecasting firm in Lexington, Mass. One reason is that many big U.S. exporters, such as heavy-equipment manufacturer Caterpillar Inc. and airplane maker Boeing Co., have huge backlogs of orders that will take a long time to work through.

Mr. Gault says sooner or later, though, slower growth in the rest of the world—now visible in Japan and Europe—will translate into slower growth in foreign demand for U.S. goods. This, combined with a stronger or at least stable dollar, should damp the torrid pace of export growth.

But for now, exports will continue creating pockets of relative strength amid the larger slowdown. The farming, energy and aerospace sectors, in particular, have helped fuel export growth throughout the country.

The industrial Midwest, for example, has suffered plant shutdowns and job cuts from slumping auto sales. The region's many makers of household goods such as appliances and building materials have likewise been hurt

billion of it from plants in Columbus. One of the company's biggest exports is fuel systems for diesel engines made in Columbus.

The ripples from the export economy reach far and wide. Growing exports of farm products have meant work for everyone from truck drivers who haul pigs to slaughterhouses to thousands of businesses that broker and process grains, produce cheese or package frozen meat.

And more products to ship have meant jobs for construction workers expanding ports: Crews began work last fall on a $660 million terminal at the former Navy

phy. Many bigger cities, including New York and Boston, have hefty exports in dollar terms, but their shipments to foreign customers are dwarfed by their domestic-oriented economies.

Local export numbers are also maddeningly imprecise. In an economy as vast and complex as the U.S.'s, it is impossible to pinpoint the origins of some products, such as corn and milk, which originate in a wide swath of the country. In many cases, items get counted as exports based on where they are processed or loaded onto ships for export.

This explains why Laredo,

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W4 *Saturday/Sunday, September 27 - 28, 2008*

COVE

ESSAY

A Hope for America

Continued from page W1
here and the child is crying over there. And of course as a former president, with the entourage and the private jets, he never will.

Nor will Bill Clinton, nor the senators and leaders who fly by private jet.

I bet a lot of Americans, most Americans, don't like it. I'm certain Gate 14 doesn't.

ALL THIS IS PART of the mood of the moment. It is marked in part by a sense that our great institutions are faltering, that they've forgotten the mission; that the old America in which we were raised is receding, and something new and quite unknown is taking its place; that our leaders have gone astray. There is even a feeling, a faint sense sometimes that we have been relegated to the role of walk-on in someone else's drama, that as citizens we are crucial and yet somehow...extraneous.

But we are Americans, and mean to make it better. We long to put the past few years behind us, move on, and write something good on the page we sense turning.

In all this I am not saying, as Rodney King did, Why can't we all just get along? We can't because we're human: something's wrong with us. But we can do better.

I don't mean "we must outlaw politics," or "splitting the difference is always best." Politics is a great fight and must be a fight; that is its purpose. We are a great democratic republic, and we struggle with great questions. But we can approach things in a new way, see in a new way, speak in a new way. We can fight honorably and in good faith, while—and this is the hard one—both summoning and assuming good faith on the other side.

To me it is not quite a matter of "rising above partisanship," though that can be a very good thing. It's more a matter of remembering our responsibilities and reaffirming what it is to be an American.

If nothing else, this means we must now have our fights over *big* issues, issues of real consequence that are pertinent to the moment we're in. We shouldn't be fighting and hitting each other over the head over little things, stupid things, needlessly chafing ones. When I would think of this the past few years I'd always return to one thing, a prime example of the old way of doing politics. This was the movement, now quiescent, to alter the Constitution of the United States to outlaw...flag burning. Imagine changing that great document for such a stupid thing. As if it meant anything if an idiot burned a flag; as if a lot of idiots were even burning flags—which they weren't, and aren't. I called it a movement, but of course it wasn't: it was a political game played by one team in order to embarrass the other. *"He doesn't love our flag—he won't even protect it!"* Boo! goes the crowd.

And yet the oddest thing is...the crowd knows it's being played. They know their buttons are being pushed. And this doesn't leave them feeling more inspired by, more trusting in, the system. So much of our silliness is, in the end, destructive.

And so I came to think this: What we need most right now, at this moment, is a kind of patriotic grace—a grace that takes the long view, apprehends the moment we're in, comes up with ways of dealing with it, and eschews the politically cheap and manipulative. That admits affection and respect. That encourages them. That acknowledges that the small things that divide us are not worthy of the moment; that agrees that the things that can be done to ease the stresses we feel as a nation should be encouraged, while those that encourage our cohesion as a nation should be supported.

SO WHERE are we now? I yank this into the present to look at the landscape on which a rise to the challenge is possible, but not, I'm afraid, [illegible]ly.

It is autumn and America is picking a [illegible]t has been exciting. The whole year was confounding, putting the professional political class in its place, leaving the experts scratching their heads, and giving us all the feeling—so precious, so rare—that the people are in charge. They make the decisions, not pollsters. And you never knew what they'd do next. John McCain was over and done a year

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THE WALL STREET JOURNAL.

R STORY

What we need most right now, at this moment, is a kind of patriotic grace—a grace that **takes the long view**, apprehends the moment we're in and eschews the politically cheap and manipulative.

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themselves then very much because of their surrogates or would-be surrogates—a million freelancers and operatives, YouTube Fellinis, and political action committees.

Two huge teams are in a massive public brawl in an era in which the Internet has liberated everyone in the country from the old restrictions, the old establishment, the old, encrusted media monopoly.

YouTube has yielded, this year, the most moving and wittiest advertisements about each of the candidates. Professional political consultants with their piece of the buy didn't produce them, artists did. For Obama, it was the video by will.i.am, wi[redacted]ama speech and the snatches [redacted] song [redacted]ade from his words. More tha[redacted]ng else this year, it captured the feeling behind his movement. The McCain video, alas, was anti-McCain, and keyed off the will.i.am video. It featured young people and artists taking snatches of McCain speeches, turning them into song, and then starting to...

The overarching political question: In a time of heightened anxiety, will people inevitably lean toward the older congressional vet, the guy who's been around forever? Why take a chance on the new, young man at a time of crisis? Wouldn't that be akin to injecting an unstable element into an unstable environment? There's a lot at stake.

Or will people have the opposite reaction? *I've had it, the system has been allowed to corrode and collapse under seven years of Republican stewardship. Throw the bums out. We need change. Obama may not be experienced, but that may help him cut through. He's not compromised.*

The election, still close, still unknowable, may well hinge on whether people conclude A or B.

PATRIOTIC GRACE
PEGGY NOONAN

Adapted from "Patriotic Grace: What It Is and Why We Need It Now," by Peggy Noonan. Copyright 2008 by Peggy Noonan. Published by Collins, an imprint of HarperCollins Publishers.

THE WALL STREET JOURNAL.

COMMON SENSE

Time to Ask What

By James B. Stewart

As president, Franklin Roosevelt confronted far more dire circumstances [redacted] anything we've experienced [redacted] my [redacted]fetime, let alone last week, a[redacted] he never succumbed to panic, desperation, greed or, most famously, fear.

In 1932, in the depths of the Depression, Roosevelt gave the commencement address at Oglethorpe University in Atlanta: "The country demands bold, persistent experimentation. It is common sense to take a method and try it. If it fails, admit it frankly and try another. But above all, try something."

The proximate cause of last week's crisis in the financial markets, which evidently brought us to the brink of economic catastrophe, was paralysis: the refusal of banks to lend virtually anything, even overnight loans to their fellow bankers; the immediate demands for repayment of collateral and the refusal of investors to trust counterparties; the aversion to all forms of risk, real or perceived.

As paralysis seemed to grip our major financial institutions, I felt some of this myself. One day last week I returned to my desk to find **Morgan Stanley** trading at $18 as rumors swirled that it would be forced into a merger by week's end. **Goldman Sachs** (whose shares I own) had

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Details of the B tion's bold and cos this market psycho as much as $700 b mountains of mort and other toxic se crushing the balar cial institutions re haps by design. Co should debate issu executive compen sure relief, but the sues that have cau The government n ple plan that offer [redacted] heart [redacted]nd jolts the [redacted] to beating [redacted] am not goi uncertainties and though they are. T

THE WALL STREET JOURNAL.

OPINION

Bad Accounting Rules Helped

By Zachary Karabell

The decision by the Federal Reserve to loan insurance giant AIG $85 billion in return for as much as 80% ownership of the company is by any measure dramatic. The takeover early last week of Fannie Mae and Freddie Mac represented the culmination of years of intermingling of public an[redacted]ivate interests. But the AIG mov[redacted] is [redacted] facto a government nationaliza[redacted]of an ailing private company, which, if not unprecedented, has rarely happened in the United States. Even if the intervention was imperative, its scope is startling.

The crisis on Wall Street has, of course, become a political football. Cries of "moral haz[redacted]cial-ism" on one side ar[redacted] drowned [redacted]ut by charges that the cu[redacted]s the result of deregulation, and too cozy a relationship between "Wall Street fat cats" and the current administration in Washington. If only reality were that simple. The blame game will continue, but it won't do much to fix what's broken.

Let's get a few canards out of the way: First, yes, stupidity and cupidity and complacency and hubris are involved, and yes, there is gambling in Casablanca. Second, the idea that there is this thing called "the free market" that governments tame or muck up with regulation is a fiction.

Beware of calls for more regulation. Washington helped create this mess.

Governments create the legal conditions for markets; markets shape what governments can do or are willing to do. Regulation versus free-market is a false dichotomy. Maybe in some theoretical universe, if we could start with a blank slate and construct society anew, it wouldn't be. But we exist in a web of markets and regulations, and the challenge is to respond to problems in such a way so that we decrease the odds of future crises.

And that is where AIG becomes instructive. Even good regulations can't prevent all future crises, especially ones that are the result of new technologies and changes that result from them. The capital flows, derivatives contracts and nearly frictionless interlinking of global markets today are the direct result of the information technologies of the 1990s. The implications weren't known until very recently, so it would have been nearly impossible for regulations to have prevented what is happening. But if good regulation can't prevent crises, bad regulations can cause them.

The current meltdown isn't the result of too much regulation or too little. The root cause is bad regulation.

Call it the revenge of Enron. The collapse of Enron in 2002 triggered a wave of regulations, most notably Sarbanes-Oxley. Less noticed but ultimately more consequential for today were accounting rules that forced financial service companies to change the way they report the value of their assets (or liabilities). Enron valued future contracts in such a way as to vastly inflate its reported profits. In response, accounting standards were shifted by the Financial Accounting Standards Board and validated by the SEC. The new standards force companies to value or "mark" their assets according to a different set of standards and levels.

The rules are complicated and arcane; the result isn't. Beginning last year, financial companies exposed to the mortgage market began to mark down their assets, quickly and steeply. That created a chain reaction, as losses that were reported on balance sheets led to declining stock prices and lower credit ratings, forcing these companies to put aside ever larger reserves (also dictated by banking regulations) to cover those losses.

In the case of AIG, the issues are even more arcane. In February, as its balance sheet continued to sharply decline, the company issued a statement saying that it "believes that its mark-to-market unrealized losses on the super senior credit default swap portfolio . . . are not indicative of the losses it may realize over time." Unless one is steeped in these issues, that statement is completely incomprehensible. Yet the inside baseball of accounting rules, regulation and markets adds up to the very comprehensible $85 billion of taxpayer money.

What AIG was saying then, and what others from Lehman to Bear Stearns to the world at large have been saying since, is that the losses showing up aren't "real." Yes, the layer upon layer of derivatives built on the foundation of mortgages is mind-boggling. One reason that AIG had floated beneath the radar screen of the business media (relative to Wall Street investment firms) is that its business model is so complex and opaque that it is impossible to describe simply. It was briefly in the news in 2005, after it was accused of improper accounting by the SEC and the New York attorney general. Then it faded from view, until now.

Among its many products, AIG offered insurance on derivatives built on other derivatives built on mortgages. It priced those according to computer models that no one person could have generated, not even the quantitative magicians who programmed them. And when default rates and home prices moved in ways that no model had predicted, the whole pricing structure was thrown out of whack.

The value of the underlying assets—homes and mortgages—declined, sometimes 10%, sometimes 20%, rarely more. That is a hit to the system, but on its own should never have led to the implosion of Wall Street. What has leveled Wall Street is that the value of the derivatives has declined to zero in some cases, at least according to what these companies are reporting.

There's something wrong with

Chanson d'Automne, crayons gras sur pages du *Wall Street Journal* de septembre 2008.

A8 Thursday, September 18, 2008 • • • • • THE WALL STREET JOURNAL.

THE FINANCIAL CRISIS

Worst Crisis Since 1930s, With No End Yet in Sight

Continued from Page One

Co. to Bank of America Corp. Each episode seems to bring government intervention that is more extensive and expensive than the previous one, and carries greater risk of unintended consequences.

Expectations for a quick end to the crisis are fading fast. "I think it's going to last a lot longer than perhaps we would have anticipated," Anne Mulcahy, chief executive of Xerox Corp., said Wednesday.

"This has been the worst financial crisis since the Great Depression. There is no question about it," said Mark Gertler, a New York University economist who worked with fellow academic Ben Bernanke, now the Federal Reserve chairman, to explain how financial turmoil can infect the overall economy. "But at the same time we have the policy mechanisms in place fighting it, which is something we didn't have during the Great Depression."

Spreading Disease

The U.S. financial system resembles a patient in intensive care. The body is trying to fight off a disease that is spreading, and as it does so, the body convulses, settles for a time and then convulses again. The illness seems to be overwhelming the self-healing tendencies of markets. The doctors in charge are resorting to ever-more-invasive treatment, and are now experimenting with remedies that have never before been applied. Fed Chairman Bernanke and Treasury Secretary Henry Paulson, walking into a hastily arranged meeting with congressional leaders Tuesday night to brief them on the government's unprecedented rescue of AIG, looked like exhausted surgeons delivering grim news to the family.

Fed and Treasury officials have identified the disease. It's called deleveraging, or the unwinding of debt. During the credit boom, financial institutions and American households took on too much debt. Between 2002 and 2006, household borrowing grew at an average annual rate of 11%, far outpacing overall economic growth. Borrowing by financial institutions grew by a 10% annualized rate. Now many of those borrowers can't pay back the loans—a problem that is exacerbated by the collapse in housing prices. They need to reduce their dependence on borrowed money, a painful and drawn-out process that can choke off credit and economic growth.

At least three things need to happen to bring the deleveraging process to an end, and they're hard to do at once. Financial institutions and others need to fess up to their mistakes by selling or writing down the value of distressed assets they bought with borrowed money. They need to pay off debt. Finally, they need to rebuild their capital cushions, which have been eroded by losses on those distressed assets.

But many of the distressed assets are hard to value and there are few if any buyers. Deleveraging also feeds on itself in a way that can create a downward spiral: Trying to sell assets pushes down the assets' prices, which makes them harder to sell and leads firms to try to sell more assets. That, in turn, suppresses these firms' share prices and makes it harder for them to sell new shares to raise capital. Mr. Bernanke, as an academic, dubbed this self-feeding loop a "financial accelerator."

"Many of the CEO types weren't willing...to take these losses, and say, 'I accept the fact that I'm selling these way below fundamental value,'" said Anil Kashyap, a University of Chicago Business School economics professor. "The ones that had the biggest exposure, they've all died."

Deleveraging started with securities tied to subprime mortgages, where defaults started rising rapidly in 2006. But the deleveraging process has now spread well beyond, to commercial real estate and auto loans to the short-term commitments on which investment banks rely to fund themselves. In the first quarter, financial-sector borrowing slowed to a 5.1% growth rate, about half the average from 2002 to 2007. Household borrowing has slowed even more, to a 3.5% pace.

Not Enough

Goldman Sachs Group Inc. economist Jan Hatzius estimates that in the past year, financial institutions around the world have already written down $408 billion worth of assets and raised $367 billion worth of capital.

But that doesn't appear to be enough. Every time financial firms and investors suggest that they've written assets down enough and raised enough new capital, a new wave of selling triggers a reevaluation, propelling the crisis into new territory. Residential mortgage losses alone could hit $636 billion by 2012, Goldman estimates, triggering widespread retrenchment in bank lending. That could shave 1.8 percentage points a year off economic growth in 2008 and 2009—the equivalent of $250 billion in lost goods and services each year.

"This is a deleveraging like nothing we've ever seen before," said Robert Glauber, now a professor of Harvard's government and law schools who came to Washington in 1989 to help organize the savings and loan cleanup of the early 1990s. "The S&L losses to the government were small compared to this."

Hedge funds could be among the next problem areas. Many rely on borrowed money to amplify their returns. With banks under pressure, many hedge funds are less able to borrow this money now, pressuring returns. Meanwhile, there are growing indications that fewer investors are shifting into hedge funds while others are pulling out. Fund investors are dealing with their own problems: Many have taken out loans to make their investments and are finding it more difficult now to borrow.

That all makes it likely that more hedge funds will shutter in the months ahead, forcing them to sell their investments, further weighing on the market.

Debt-driven financial traumas have a long history, from the Great Depression to the S&L crisis to the Asian financial crisis of the late 1990s. Neither economists nor policymakers have easy solutions. Cutting interest rates and writing stimulus checks to families can help—and may have prevented or delayed a deep recession. But, at least in this instance, they don't suffice.

In such circumstances, governments almost invariably experiment with solutions with varying degrees of success. President Franklin Delano Roosevelt unleashed an alphabet soup of new agencies and a host of new regulations in the aftermath of the market crash of 1929. In the 1990s, Japan embarked on a decade of often-wasteful government spending to counter the aftereffects of a bursting bubble. President George H.W. Bush and Congress created the Resolution Trust Corp. to take and sell the assets of failed thrifts. Hong Kong's free-market government went on a massive stock-buying spree in 1998, buying up shares of every company listed in the benchmark Hang Seng index. It ended up packaging them into an exchange-traded fund and making money.

Taking Out the Playbook

Today, Mr. Bernanke is taking out his playbook, said NYU economist Mr. Gertler, "and rewriting it as we go."

Merrill Lynch & Co.'s emergency sale to Bank of America Corp. last weekend was an example of the perniciousness and unpredictability of deleveraging. In the past year, Merrill had hired a new chief executive, written off $41.4 billion in assets and raised $21 billion in equity capital.

But Merrill couldn't keep up. The more it raised, the more it was forced to write off. When Merrill CEO John Thain attended a meeting with the New York Fed and other Wall Street executives last week, he saw that Merrill was the next most vulnerable brokerage firm. "We watched Bear and Lehman. We knew we could be next," said one Merrill executive. Fearful that its lenders would shut the firm off, he sold to Bank of America.

This crisis is complicated by innovative financial instruments that Wall Street created and distributed. They're making it harder for officials and Wall Street executives to know where the next set of risks is hiding and also contributing to the crisis's spreading impact.

Swaps Game

The latest trouble spot is an area called credit-default swaps, which are private contracts that let firms trade bets on whether a borrower is going to default. When a default occurs, one party pays off the other. The value of the swaps rise and fall as the market reassesses the risk that a company won't be able to honor its obligations. Firms use these instruments both as insurance—to hedge their exposures to risk—and to wager on the health of other companies. There are now credit-default swaps on more than $62 trillion in debt, up from about $144 billion a decade ago.

One of the big new players in the swaps game was AIG, the world's largest insurer and a major seller of credit-default swaps to financial institutions and companies. When the credit markets were booming, many firms bought these instruments from AIG, believing the insurance giant's strong credit ratings and large balance sheet could provide a shield against bond and loan defaults. AIG believed the risk of default was low on many securities it insured.

As of June 30, an AIG unit had written credit-default swaps on more than $446 billion in credit assets, including mortgage securities, corporate loans and complex structured products. Last year, when rising subprime-mortgage delinquencies damaged the value of many securities AIG had insured, the firm was forced to book large write-downs on its derivative positions. That spooked investors, who reacted by dumping its shares, making it harder for AIG to raise the capital it increasingly needed.

Credit default swaps "didn't cause the problem, but they certainly exacerbated the financial crisis," said Leslie Rahl, president of Capital Market Risk Advisors, a consulting firm in New York. The sheer volume of CDS contracts outstanding—and the fact that they trade directly between institutions, without centralized clearing—intertwined the fates of many large banks and brokerages.

Few financial crises have been sorted out in modern times without massive government intervention. Increasingly, officials are coming to the conclusion that even more might be needed. A big problem: The Fed can and has provided short-term money to sound, but struggling, institutions that are out of favor. It can, and has, reduced the interest rates it influences to attempt to reduce borrowing costs through the economy and encourage investment and spending.

But it is ill-equipped to provide the capital that financial institutions now desperately need to shore up their finances and expand lending.

Resolution Trust Scenario

In normal times, capital-starved companies usually can raise money on their own. In the current crisis, a number of big Wall Street firms, including Citigroup Inc., have turned to sovereign-wealth funds, the government-controlled pools of money.

But both on Wall Street and in Washington, there is increasing expectation that U.S. taxpayers will either take the bad assets off the hands of financial institutions so they can raise capital, or put taxpayer capital into the companies, as the Treasury has agreed to do with mortgage giants Fannie Mae and Freddie Mac.

One proposal was raised by Barney Frank, the Massachusetts Democrat who is chairman of the House Financial Services Committee. Rep. Frank is looking at whether to create an analog to the Resolution Trust Corp., which took assets from failed banks and thrifts and found buyers over several years.

"When you have a big loss in the marketplace, there are only three people that can take the loss—the bondholders, the shareholders and the government," said William Seidman, who led the RTC from 1989 to 1991. "That's the dance we're seeing right now. Are we going to shove this loss into the hands of the taxpayers?"

The RTC seemed controversial and ambitious at the time. Any version today would be even more complex. The RTC dispensed mostly of commercial real estate. Today's troubled a sets are complex debt securitie many of which include pieces other instruments, which in tu include pieces of others, ma steps removed from the actu mortgages or consumer loans which they are based. Unrav ing these strands will be tedic and getting at the underlying c lateral, difficult.

In the early stages of this c sis, regulators saw that th rules didn't fit the rapidly char ing financial system they we asked to oversee. Investme banks, at the core of the cris weren't as closely monitored the Securities and Exchan Commission as commerc banks were by their regulator

The government has a syst to close failed banks, created ter the Great Depression in pa to avoid sudden runs by depo tors. Now, runs happen in spher regulators may not fully und stand, such as the repurcha agreement, or repo, market, which investment banks fu their day-to-day operations. A regulators have no process f handling the failure of an inve ment bank like Lehman Brothe Holdings Inc. Insurers like A aren't even federally regulated

Regulators have all but pro ised that more banks will fail the coming months. The Fede Deposit Insurance Corp. is dra ing up a plan to raise the pren ums it charges banks so that can rebuild the fund it uses back deposits. Examiners a tightening their leash on ban across the country.

Pleasant Mystery

One pleasant mystery is w the crisis hasn't hit the econor harder—at least so far. "This nancial crisis hasn't yet tran lated into fewer...compani starting up, less research and c velopment, less marketin Ivan Seidenberg, chief executi of Verizon Communicatio said Wednesday. "We haven seen that yet. I'm sure every co pany is keeping their eyes on i

At 6.1%, the unemployme rate remains well below the pe of 7.8% in 1992, amid the S&L cris

In part, that's because gover ment has reacted aggressive The Fed's classic mistake th led to the Great Depression w that it tightened monetary po icy when it should have ease Mr. Bernanke didn't repeat th error. And Congress mov more swiftly to approve fisc stimulus than most Washingt veterans thought possible.

In part, the broader econon has held mostly steady becau exports have been so strong just the right moment, a r minder of the global economy importance to the U.S. And part, it's because the U.S. eco omy is demonstrating impressi resilience, as information tec nology allows executives to rea more quickly to emerging pro lems and—to the discomfort workers—companies are quick to adjust wages, hiring and wo hours when the economy soften

But the risk remains th Wall Street's woes will spread Main Street, as credit tighte for consumers and business. A ready, U.S. auto makers hav been forced to tighten the tern on their leasing programs, abandon writing leases ther selves altogether, because problems in their finance unit Goldman Sachs economists' *op mistic* scenario is a couple yea of mild recession or painfully slow economy growth.

—Aaron Lucchetti, Mark Whitehouse, Gregory Zuckerman and Sudeep Reddy contributed to this article.

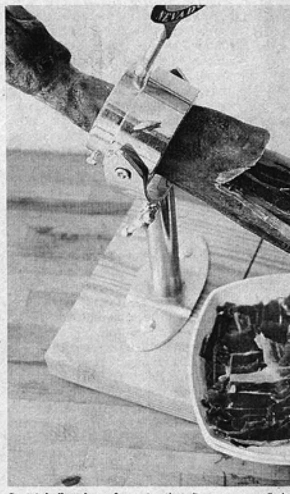
Getty Images

Traders on the floor of the **New York Stock Exchange** Wednesday. Expectations for a quick end to the crisis are fading fast.

EATING OUT | By Raymond Soko

High on t

Savoring the elusive bellota



Spain's **bellota ham,** from pigs that dine on acorns (belo

NEXT MONTH, restaurants across the U.S. will at last be able to serve the world's best and costliest cold cut—legally, that is—for an expected $50 or so a plate.

Anyone with the time and the euros has been able to fly to Spain and taste *jamon iberico de bellota*, the aged, acorn-fed ham of black-footed pigs. But here in food-fearing America, official approval for this glistening, fat-streaked delicacy dragged on. At one Manhattan tapas bar, the owner offered contraband portions of bellota and even advertised the ham on his Web site—until U.S. Customs nabbed one of those precious porcine back legs. That forced the owner to get in line with Mario Batali and other high-on-the-hog restaurateurs who await bellota's legal entry into the country as early as next week.

Early adopters who sent a deposit of $199 to Latienda.com, an Internet source for imported Spanish delicatessen, will be billed the balance of the approximate total charge of $1,500 for a single bellota ham. The Web shipper calculates that will work out to about $96 a pound, or $6 an ounce.

Eager for a taste, I paid a visit earlier this month to Casa Mono, Mr. Batali's inventive Manhattan tapas restaurant. Lacking the real thing, he apologetically served me the cured shoulder of a bellota porker, which became importable sooner than hams from the same animals. Bellota (Spanish for acorn) acquires its complex, profound flavor from the pigs' unusual diet as well as from the two to four years the hams are hung up to air-cure. (Unlike most American hams, bellota isn't smoked or subjected to heavy doses of salt to cure it.) But even the bellota shoulder "ham" was pretty fabulous, or at least fabulous enough to get Molto Mario to sniff it like fine wine.

Both of us had tasted back-leg bellota ham in Spain, and we knew it had an even more elegant texture than the shoulder (*paleta* in Spanish). But I didn't trust my memory going back several years to a heavenly ham mo-

FOOD

...lov

...he Hog

... ham, soon to be legal in the

...w), will finally be available in the U.S. Toronto's Cava restau...

in Seville. So to get a jump on ...ellota bandwagon, I found a ...e for the real thing right here in America—in Canada, which legal... the importation a few weeks be... ts lumbering cousin to the south. ...lew to Toronto to check it out. ..., on Yonge Street, said to be the ...st street in the world, I found a ...nal but baroquely ambitious and ...-date place called Cava. Cava is ...ame given to champagne-pro... sparkling wine made in Spain. ...the restaurant serves an imagi... e array of foods inspired by the ...-plate dishes one might find in a ...sh tapas bar. The menu proudly ...he essential item in the tradi... l tapas menu, *jamon serrano*, the ...ntly hearty mountain ham that ...een available in the U.S. for ... years now. But Cava also has be... erving bellota, though as an off-... enu special because of difficul... ith supply.

...as it worth the trip? Well, I ...d a taste scoop. A beautifully cut ...of translucent ham cost me 25 ...lian dollars (a little less than ...5). I didn't weigh it, but I would ...was served as much as four

ounces, whic... of manzanill... tensive sherr... half the expe... lota serving ... travel expen...

This ham ... behold, but i... tounding ran... the register ... challenged t... was a "ham ... est praise fo... "Li'l Abner." ... family ate in ... hamlet of Do... quite differe... ern country ham of the salty, rough-and-ready variety that aficionados like me gobble down with redeye gravy. By contrast, *jamon iberico de bellota* is a miracle of low-sodium refinement coaxed from pampered pigs that range at leisure over wide swaths of land, munching acorns while their hindquarters swell.

...ee the result of all this languorous alanophagy (Greek for ...eating) on your plate. This is the only ham that has lacy lines of fat looping through the whole visual field of every slice. And the fat is what gives the ham its plush, porky flavor.

Cholesterol nannies will note that bellota's sole importer, Fermin, publishes a chart of "nutrition facts" that advertises 87.9 calories for a one-ounce serving, of which 55.2 calories are from fat, about half of it saturated. This is not your cardiologist's idea of health food.

Only a handful of corpulent hedge-fund managers are likely to manage a steady enough diet of bellota for it to be a health worry. But should you be searching for an excuse to eat more of it, just remember: Bellota is a shining example of sustainable agriculture. Spanish farmers let their pigs loose in oak forests to feed exclusively on acorns for the last three months of their lolling lives. And acorns, properly managed, are—do I need to tell you?—a renewable resource.

Email me at eatingout@wsj.com.

THE WALL STREET JOURNAL.

DOW JONES A NEWS CORPORATION COMPANY · · · · · TUESDAY, SEPTEMBER 30, 2008 - VOL. CCLII NO. 77 ★★★★ $2.00

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Bailout Plan Rejected, Markets Plunge, Forcing New Scramble to Solve Crisis

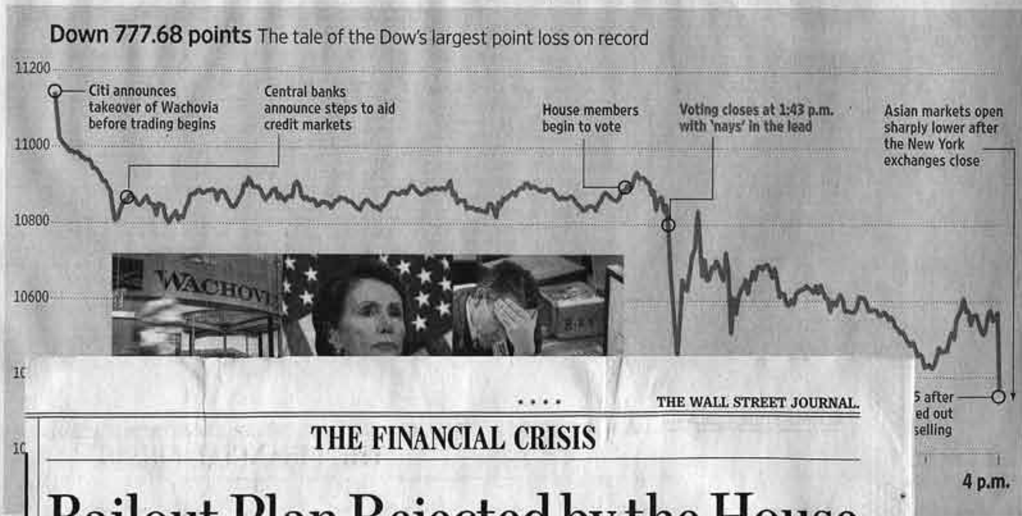
BY SARAH LUECK, DAMIAN PALETTA AND GREG HITT

WASHINGTON—The House of Representatives defeated the White House's historic $700 billion financial-rescue package—a stunning turn of events that sent the stock market into a tailspin and added to concerns that the U.S. faces a prolonged recession if the legislation isn't revived.

The Dow Jones Industrial Average sustained its biggest point drop in history and its biggest closing decline since the day the markets re-opened after the Sept. 11, 2001, terrorist attacks. The Dow, which had opened sharply lower on fears of more possible bank failures, finished the day down 7%, with a 777.68 point drop to 10365.45. Losses to shares on the broader Dow Jones Wilshire 5000 index amounted, on paper, to $1.2 trillion—eclipsing the size of the proposed bailout package. The Nasdaq Stock Market finished down 9.1%.

The widely watched VIX index, a measure of market volatility often called "the fear index," closed at its highest levels in its 28-year history. In early trading in Asia Tuesday, Japan's Nikkei was off 4.5%, and other markets also were down.

The 228-205 vote, which defied a full-court press from the president and the Treasury secretary, marked a dark moment in a month that has shaken the financial system to its core and forced the government to take a host of ad hoc measures to shore up confidence. Earlier Monday, U.S. authorities helped arrange the sale of Wachovia Corp. to Citigroup Inc., while the Federal Reserve joined



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· · · · THE WALL STREET JOURNAL.

THE FINANCIAL CRISIS

Bailout Plan Rejected by the House

Continued from Page One

crafted an agreement over the weekend that was supposed to appease these simmering tensions.

But Monday's vote split both parties, whose members had been barraged all week with angry messages from constituents who opposed the bill. Among Democrats, 140 supported the bill and 95 voted against. Support among Republicans, who had revolted against an earlier iteration of the bill last week, was at the low end of what was expected by the House Republican leadership, with 65 in favor and 133 against. One Republican, retiring Rep. Jerry Weller of Illinois, did not vote.

In voting against the bill, conservatives who opposed government intervention were joined by many Democrats facing tight races in November. Other no votes were cast by House members from poorer districts, including members of the Congressional Black and Hispanic caucuses.

Of the 18 Democratic and Republican incumbents in close races—classified "tossup" contests by the Cook Political Report—just three voted for the bill. All six freshmen Democrats in tossup races voted against the bill.

Congressional leaders said they intended to go back to work on the bill, with a new vote possibly late in the week after the Jewish holiday of Rosh Hashanah, which began at sundown Monday and runs through Wednesday night.

'Calm Down and Relax'

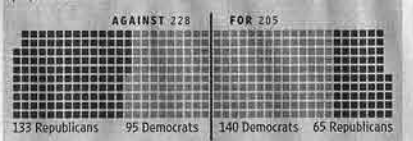
But complex election-year politics make the outcome hard to predict. "We are going to continue to work," said Rep. Steny Hoyer, House majority leader. John Boehner, his Republican counterpart, suggested there would be further efforts to change the bill. "...d everybody to calm dow... and ...elax and get back to work," ...said.

Democrats face a choice whether to continue work on a bipartisan bill or try to pass the bill with a majority of their party alone. That would likely mean reviving points that Republicans oppose, including an economic-stimulus package and a controversial provision that would allow bankruptcy-court judges to alter the terms of mortgages. For now, House Speaker Pelosi is committed to a "bipartisan bill," a Democratic leadership aide said.

Following the bill's failure...

Falling Short

House leaders were unable to wrangle enough votes to pass the proposed bailout bill.



1 not voting; 1 vacancy

Source: House of Representatives

policies ...ing deregulation. "For to... long ...his government, eight ye... followed a right-wing ideology of anything goes, no supervision, no discipline, no regulation," Rep. Pelosi said. "It has created not jobs, not capital; it has created chaos."

Rep. Eric Cantor of Virginia held up a copy of the remarks at a press conference held by Republican leaders and said Rep. Pelosi's "failure to listen and failure to lead" was to blame for some Republican defections.

Rep. Roy Blunt, the minority whip, said that "a couple" of Republicans said they were offended by the speaker and changed their minds. But he said those lawmakers were already wavering.

Rep. David Obey, a Wisconsin Democrat who stood watching the Republicans criticize Rep. Pelosi, called their remarks "ridiculous." He said the Republicans were jockeying for position before upcoming leadership elections. "The President wouldn't have gotten to first base without the cooperation of the Democratic leadership," Rep. Obey said. "Evidently some of these guys would rather lose the economy than lose the election."

Henry Paulson

The measure would have given Treasury a $700 billion line of credit and wide authority to buy the mortgages, securities and financial assets that are undermining market confidence.

The Bush administration had hoped the plan would stabilize financial markets as bad assets are pulled under the government's wing. Under the legislation, troubled banks and investment firms would qualify for government assistance, as would pension plans, local govern-...

ing the administration virtually unfettered power to spend the money as it saw fit. During a week of negotiations, the bill swelled with extra conditions and protections for taxpayers.

On Thursday, President George W. Bush convened a White House summit in a bid to unite leaders of both parties, as well as presidential candidates Sens. Barack Obama and John McCain, behind the proposal. But conservative House Republicans, encouraged by the return to Washington of Sen. McCain, demanded additions to make the bill more "free market." The dissention derailed an already contentious summit.

The administration, meanwhile, failed to get a handle on the politics of the package. It was quickly dubbed a "Wall Street bailout." Although President Bush talked repeatedly about the impact of restricted lending on small businesses, jobs and savings, a populist uproar continued to tag the bill as a rescue plan for the financial whizzes who caused the financial mess. In addition, lawmakers were frustrated with the terse answers from Treasury about how exactly the money would be spent.

"I guess [Democrats] saw the same problems we did and they didn't want to go home and explain this thing," said Rep. Scott Garrett, a Republican from New Jersey who voted against the bill.

When the deal was brokered, Democrats said they planned to come up with 120 votes. Party leaders drew votes from the New York delegation, which tends to be sensitive to stock-market concerns, and gained support from moderate Democrats.

On the Republican side, Rep...

tions. I just didn't like the answers."

Shortly after noon, less than an hour before the voting began, White House spokesman Tony Fratto predicted the votes would be there. He said that Vice President Dick Cheney and senior aides, including chief of staff Josh Bolten and counselor Ed Gillespie, were also making calls. "I think everyone with a phone is calling to see if we can shore up a member who may be skeptical of the proposal," Mr. Fratto said.

Early in the afternoon, as the vote got under way, the stock market was jittery. Investors were rattled by the weekend collapse of Dutch-Belgian bank Fortis NV and the sale of Wachovia to Citigroup. As the 15-minute window for House members to cast their vote opened shortly before 1:30 p.m., the Dow Jones Industrial Average was down by more than 250 points.

By about 1:40 p.m. the "nay" votes were slightly ahead. On trading floors, traders stood in semicircles around televisions, watching the slowly changing tally.

Lurched Downward

When the voting clock hit zero at about 1:43 p.m. with the "no" votes in the lead, the stock market lurched downward. In the span of one minute the Dow lost 100 points, extending its loss to 414 points. By 1:45 p.m., the loss reached 580 points; two minutes later, it had widened to 673 points.

Top Democrats argued about whether or not to keep the vote open to whip up enough votes, but decided against it.

Senate Democrats were in a caucus meeting when a staffer brought Senate Majority Leader Harry Reid of Nevada a note with the vote tally. Almost immediately, lawmakers began handing their BlackBerrys to each other and sharing the news, according to a person present.

Democrats, dismissing complaints about Rep. Pelosi's speech, immediately blamed Republicans for failing to deliver enough votes on their end. "Because their feelings were hurt, they're deciding to punish the country," said House Financial Services Committee Chairman Barney Frank, a Massachusetts Democrat. "We think they are covering up the embarrassment of not having the votes."

Amid the acrimony, Rep. Blunt called Reps. Hoyer and Frank, as well as several sena-...