THE RHETORIC OF MORE OF THE SAME

I’m no financial whiz (though I understand the general concept of the shitpile), so I can’t really judge the content of Paulson’s "new" plan to save our economy. But I do have a credential or two in deconstructing rhetoric—and on that level the executive summary is a fascinating document. The summary, after all, is a Bush Treasury plan to stave off any additional regulation in exchange for our recent and ongoing bailout of the financial industry. As such, it’s imperative for the summary to appear to be putting consumers’ interests at the forefront. It’s imperative for the document to downplay the panic which would justify real regulation. And it’s imperative to create the appearance of a reasoned response to a massive bailout while actually calling for diminished regulation.

We’re All Bankers Now

The summary starts by pretending that the primary purpose of the Department of the Treasury is to ensure a competitive (but stable) financial services industry.

> The mission of the Department of the Treasury ("Treasury") focuses on promoting economic growth and stability in the United States. Critical to this mission is a sound and competitive financial services industry grounded in robust consumer protection and stable and innovative markets.

Note how this differs from the Treasury’s stated mission—to ensure the **overall** health of US finances, not just the competitiveness of the financial services industry.

> Serve the American people and strengthen national security by managing the U.S. Government’s finances effectively,

> promoting economic growth and stability, and ensuring the safety, soundness, and security of the U.S. and international financial systems.

The Treasury summary justifies turning a broad mandate for ensuring the overall fiscal health of the economy into this narrow emphasis on financial services this way:

> Financial institutions play an essential role in the U.S. economy by providing **a means for consumers and businesses to save for the future**, to protect and hedge against risks, and to **access funding for consumption** or organize capital for new investment opportunities. [my emphasis]

So note, even before the summary gets into the guts of its proposed changes, it has jettisoned its concern for "safe, sound, and secure US and international financial systems" in favor of "innovative and stable financial services industry." And it has transformed your average consumer (some might call them taxpayers or even citizens) into actors who "save for the future" or "access funding for consumption." It has probably only included that consumption bit (which appears nowhere else in the summary) to establish a parallel function, for the little guy, to business' interest in "organizing capital for new investment opportunities." But I find it instructive that a document partly responding to a giant credit crisis doesn't talk about "providing a means for families to remain in their homes" or even "ensuring Americans can provide for their families," but instead reiterates the primary role accorded the little guy, in Bush's economy, to consume.

At least, at this level, the summary is honest: as Chris Dodd makes clear, there is nothing in this document that helps real people survive the current crisis.

This Is Not a Crisis

In spite of the fact that the summary offers no help to those losing their homes, it attempts to pretend this document is at once a response to this crisis, but also a document that has been crafted over time. So, for example, the summary foregrounds its genesis in the time before the crisis, a year ago. It suggests that this long deliberative process resulted in both short and medium term recommendations.

> Treasury began this current study of regulatory structure after convening a conference on capital markets competitiveness in March 2007. Conference participants, including current and former policymakers and industry leaders, noted that while functioning well, the U.S. regulatory structure is not optimal for promoting a competitive financial services sector leading the world and supporting continued economic innovation at home and abroad. Following this conference, Treasury launched a major effort to collect views on how to improve the financial services regulatory structure.
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> In this report, Treasury presents a series of "short-term" and "intermediate-term" recommendations that could immediately improve and reform the U.S. regulatory structure.

And only then does it (sort of) admit that these short term recommendations are really a response to what happened last week, not what happened last March.

> The short-term recommendations focus on taking action now to improve regulatory coordination and oversight in the wake of recent events in the credit and mortgage markets.

I find the summary even more amusing when it

tells the history of changing financial regulation in this country, which it portrays as a series of responses to crises. Except for this one, which it portrays as a response to an enhancement.

> The regulatory basis for depository institutions evolved gradually in response to a series of financial crises and other important social, economic, and political events: Congress established the national bank charter in 1863 during the Civil War, the Federal Reserve System in 1913 in response to various episodes of financial instability, and the federal deposit insurance system and specialized insured depository charters (e.g., thrifts and credit unions) during the Great Depression. Changes were made to the regulatory system for insured depository institutions in the intervening years in response to other financial crises (e.g., the thrift crises of the 1980s) or as enhancements (e.g., the Gramm-Leach-Bliley Act of 1999 ("GLB Act")); but, for the most part the underlying structure resembles what existed in the 1930s.

Herein lies the central rhetorical game in this document. It admits that every other major change in regulatory structure in our history has been a response to a crisis: The Civil War, the Savings and Loan scandal, and most of all the Depression. The one exception it lists is the Gramm-Leach-Billey Act, better known as the repeal of the Glass-Steagall Act. Fifty years from today, this current crisis will likely be perceived as (among other things) the crisis **caused** by the repeal of the Glass-Steagall Act, which allowed financial services companies to do what banks used to do without the regulation that banks have. But rather than admit that we are in a crisis, Treasury would like you to believe that, for the first time in our

regulatory history, they are suggesting a new regulatory structure because of previous **enhancements**, not a crisis. Rather than admit that the traditional and correct response to significant financial crises is to impose more regulation, Treasury is calling this something else so it can avoid doing what we've done with every previous crisis.

One Plus One Equals Three

And then the summary gets into its final word game, in which it creates the appearance of a regulatory structure that increases oversight for everyone, even while it carves out a regulatory exception so financial services companies can continue as they are—with little real oversight, even while benefiting from government backing. It does through what it calls regulation by objective, the central proposal dreamed up a year ago and tweaked in the last week.

The summary explains that it looked to other international examples to decide how it should reorganize the regulatory structure of the US.

> In addition to these prior studies, similar efforts abroad inform this Treasury report. For example, more than a decade ago, the United Kingdom conducted an analysis of its financial services regulatory structure, and as a result made fundamental changes creating a tri-partite system composed of the central bank (i.e., Bank of England), the finance ministry (i.e., H.M. Treasury), and the national financial regulatory agency for all financial services (i.e., Financial Services Authority). Each institution has well-defined, complementary roles, and many have judged this structure as having enhanced the competitiveness of the U.K. economy.
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> Australia and the Netherlands adopted another regulatory approach, the "Twin

> Peaks" model, emphasizing regulation by objective: **One financial regulatory agency is responsible for prudential regulation of relevant financial institutions, and a separate and distinct regulatory agency is responsible for business conduct and consumer protection issues**. These international efforts reinforce the importance of revisiting the U.S. regulatory structure. [my emphasis]

Much later, after reviewing its short term fixes that respond to last week's crisis (one of which is basically a retroactive rationalization for its Bear Stearns bailout), it returns to these international examples.

> While there are many possible options to reform and strengthen the regulation of financial institutions in the United States, Treasury considered four broad conceptual options in this review. First, the United States could maintain the current approach of the GLB Act that is broadly based on functional regulation divided by historical industry segments of banking, insurance, securities, and futures. Second, the United States could move to a more functional-based system regulating the activities of financial services firms as opposed to industry segments. Third, the United States could move to a single regulator for all financial services as adopted in the United Kingdom. Finally, the United States could move to an objectives-based regulatory approach focusing on the goals of regulation as adopted in Australia and the Netherlands.
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> After evaluating these options, Treasury believes that an objectives-based regulatory approach would represent the optimal regulatory structure for the future. An objectives-based approach is

> designed to focus on the goals of regulation in terms of addressing particular market failures.

Yet after claiming it has adopted the Austrailian and Dutch solution—an objectives-based regulatory approach—it then pulls a fast one (and this fast one was almost certainly inserted in the last week). The Australian and Dutch solutions have two parts, one overseeing "prudential regulation" of financial institutions, and another overseeing business conduct. But here's what the summary transforms those two parts into:

> Such an evaluation leads to a regulatory structure focusing on three key goals:
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> • Market stability regulation to address overall conditions of financial market stability that could impact the real economy;
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> • Prudential financial regulation to address issues of limited market discipline caused by government guarantees; and
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> • Business conduct regulation (linked to consumer protection regulation) to address standards for business practices.

All of a sudden, in the last week, the objectives-based approach got a third, new, objective: "market stability regulation."

There's a reason for this. The "prudential financial regulation to address issues of limited market discipline caused by government guarantees" is what we currently think of as banking regulation: the requirements that banks—and other insured institutions—have to meet in order to get that insurance. This is all the regulation and oversight that says, if the government is going to promise to bail out large financial institutions, it will make certain

demands of those financial institutions, to minimize the chances that the government is going to have to bail out those institutions.

But the Bush Administration wants those regulations to continue to apply to only those institutions it already applies to: banks and credit unions and thrifts, even while it wants to institutionalize government bailouts for companies not regulated in this way.

So to avoid having to put new regulation and oversight on the hedge funds and other financial institutions that the government has now (Bear Stearns) and will bail out, it has created a third category, one not present in the Australian and Dutch examples: a "market stability regulation" function. This is rhetorical game the summary plays to avoid the obvious: that the government has no business guaranteeing financial institutions if it doesn't also set some minimum expectations for those institutions.

Now, the summary does call for increased reporting requirements under this third authority. So presumably, this increased authority would have given the Fed the ability to demand all finance companies reveal their exposure to the shitpile (though it's unclear how it would ensure that the finance companies would be any more honest with their disclosure than they were in this case). But beyond that, it does not give the Fed the ability to make **general** requirements on the companies it effectively will bail out.

It rationalizes the creation of this giant moral hazard through use of another fiction–the discussion of such bailouts in terms of systemic risks. You see, under this authority, the Fed would never be regulating or bailing out individual companies. No. It would be regulating the entire system.

> With regard to corrective actions, **if after analyzing the information described above the Federal Reserve**

> **determines that certain risk exposures pose an overall risk to the financial system or the broader economy, the Federal Reserve should have authority to require corrective actions** to address current risks or to constrain future risk-taking. For example, the Federal Reserve could use this corrective action authority to require financial institutions to limit or more carefully monitor risk exposures to certain asset classes or to certain types of counterparties or address liquidity and funding issues.
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> The Federal Reserve's authority to require corrective actions **should be limited to instances where overall financial market stability was threatened**. The focus of the market stability regulator's corrective actions should wherever possible be **broadly based across particular institutions or across asset classes**. Such actions should be coordinated and implemented with the appropriate regulatory agency to the fullest extent possible. But the Federal Reserve would have residual authority to enforce compliance with its requirements under this authority. [my emphasis]

Which of course, eventually gets you to this position: in which Treasury proposes vast new powers for the Fed to bail out financial institutions, but cloaks those powers in terms of bailing out the entire system.

> In addition, the Federal Reserve should have the ability to undertake market stability discount window lending. Such lending would expand the Federal Reserve's lender of last resort function to include non-FIDIs. **A sufficiently high threshold for invoking market stability discount window lending (i.e., overall threat to financial system**

> **stability) should be established**. Market stability discount window lending should be focused wherever possible on broad types of institutions as opposed to individual institutions. In addition, market stability discount window lending would have to be supported by Federal Reserve authority to collect information from and conduct examinations of borrowing firms in order to protect the Federal Reserve (and thereby the taxpayer). [my emphasis]

Never mind that such bailouts will eventually translate into the bailout of individual companies—as it did with Bear Stearns. Never mind that this puts the same folks who were cheerleading the creation of the shitpile in the first place (and are still, in principle, with this document) in charge of deciding when such actions turn from "innovation" into "systemic risk."

What the Administration is saying with the creation of this third category is, "We want to rationalize the financial regulatory system. But we want to retain an exception to such regulation for the wilder and more complex financial products. So rather than admit that such a system is no longer sustainable, we will institutionalize a general 're-set' button for the entire financial system."

We will insist that the failed system remain substantially unchanged. But we will institute a way to repeatedly bail out the financial system the next time it proves—as it will—to be unsustainable.

Rather than admit that unrestrained capitalism doesn't work, we will simply implement a process to bail out the entire system, any time it needs it.

But don't worry. Treasury is also calling for the "authority to collect information from and conduct examinations of borrowing firms." You

know. To protect the taxpayer.