

War and famine. Peace and milk.

– Somali proverb

ABOUT THIS ISSUE

On November 13, 2009, EPS hosted “The Next Stage: Financial Reforms, Jobs and Housing, the Dollar and the International System,” a half-day symposium in Washington DC. The event was attended by 150 people in person, while over 6500 viewed the simultaneous webcast. The symposium was co-sponsored The Foundation for Human Progress’ Initiative for Re-thinking the Economy, the New America Foundation, and the World Trade Center, Washington DC.

This issue of EPS Quarterly is dedicated as a report of that conference. It consists of (edited) transcripts of the keynote addresses, and summaries of the three panel sessions.

Complete video and transcripts are available on the EPS website.

Opening Remarks

James K. Galbraith

There are those who say the recession is over and that the financial crisis is past. Not many of them are to be found out in the country where unemployment has passed ten percent for only the second time in my professional life; where millions are threatened with foreclosure; and where the wealth of the American middle class built up over six or seven decades has been lost to a very large extent. To be fair, we all know this. Larry Summers said, not long ago, that unemployment is likely to remain unacceptably high for unacceptably long. The question is, what are we going to do about it? Are we going to wait and hope that the slow processes of economic recuperation pull us out in four or five years’ time? Are we going to reverse course and decide that that which was done so far was the wrong policy, that what we need to do is pull back and stop doing whatever it was we had been doing? Or are we going to move forward from the first emergency reaction to the crisis and to the economic slump, and set a new strategic direction, a sustainable course – an effort that can not only generate more rapid results, but sustain through the years ahead?

If that is the path to take, then what should that course consist of? It’s an important and complex question, and to come to grips with it EPS has since the spring of this year convened working groups in four areas: financial reform and related immediate economic policy measures; security, broadly defined; a program for investment in infrastructure and energy and dealing with the larger challenge of climate change; and the technical macro-economic area of appropriate strategy for economic forecasting and budgeting.

Three of these working groups have already met and this symposium is the first fruit of this larger effort. It is based, in



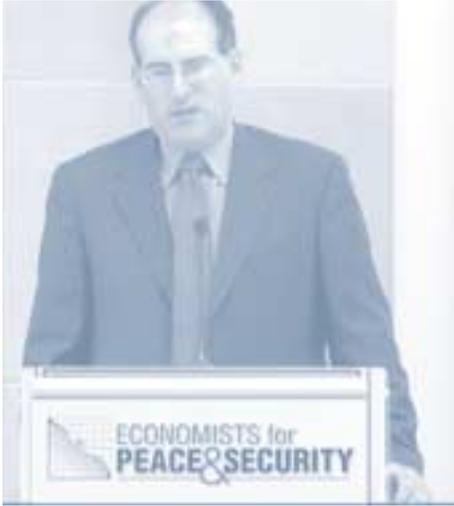
part, on meetings that were held last June and on a White Paper that was published in August. But it also responds to events as they have developed since then, and to the increasing sense of urgency that we have to develop a plausible and effective response to the rising crisis of joblessness and foreclosures.

Our program this morning will consist of three panels and two keynote speakers. I have asked the speakers on the panels to make very short, very focused interventions and to emphasize for us the concrete policy steps that they believe we, as a country and in the larger world (because there is an international dimension to this) should be considering. We’ve organized this into three areas: financial reform; the problem of jobs and housing; and the question of international monetary arrangements and the future of the dollar.

I am also pleased to say that we have two very distinguished, well-informed keynote speakers scheduled. They are Damon Silvers of the Congressional Oversight Panel and Phil Angelides, the chair of the newly-formed Financial Crisis Inquiry Commission. We are looking forward to hear what they have to say. I will just say again, thank you all for coming and I look forward with you to a very useful and enlightening morning.

Damon Silvers, Congressional Oversight Committee

Keynote address



Damon Silvers

Let me begin by giving you my Congressional Oversight Panel disclaimer. They say that elections have consequences, and one of them is that I have to give a disclaimer. I am the Deputy Chair of the Congressional Oversight Panel but my remarks today, although the will touch on some of the Congressional Oversight Panel's findings, are my own. They are not Panel's, its staff's or its chair's remarks.

Jamie has asked me to talk to you today about the challenges of and the state of regulatory reform. I have the challenge of following the last panel; some of what you will hear me say will sound familiar to you. You've had the pleasure of hearing from the real thought leaders on this subject already. I'm going to try to give you some of the legislative context as well as a few ideas about this.

The financial crisis proved what I think of as a series of propositions about financial regulation, which a number of folks had been trying to articulate throughout the deregulatory period. In certain respects it began in the 1970s, but it really began with a vengeance in the 1990s. We've heard a lot about some of these propositions, for example, the proposition that risk needs to be backed with capital. That proposition you've seen a lot of newspaper commentary on. I think we've also seen a lot

of commentary about the proposition, and I think President Obama said it best in his speech to Cooper Union during the campaign, that we ought to regulate based on the economic reality of financial activity, not based on what the lawyers call it. Those types of propositions have, I think, been relatively well covered.

I think there is a more fundamental one (that has been forgotten in the post-post-New Deal environment) that is at the heart of what went wrong in our regulatory system, and that is at the heart of the battle underway today in Congress over financial reform. That proposition is that regulation of the financial markets is not a matter simply of protecting the weak. This may seem sort of counter-intuitive. Liberal public policy, I believe, since the 1970s increasingly focused on the idea that we could regulate interactions of large sophisticated parties with the weak – consumers, workers and the like – and leave transactions between large, sophisticated parties to the parties themselves. It's a way of allocating regulatory resources and it was an idea that kind of captured the romance of markets that was predominant in policy thinking over the last generation.

It's directly contrary to the thinking of the New Deal. The fundamental thinking of the New Deal was that if you leave big parties to deal with themselves as they see fit, they will endanger the economy as a whole, perhaps the society as a whole. The regulation of the behavior and interaction of large sophisticated parties was key to the regulatory structures of the New Deal era. Recapturing that notion of regulation is key to whether regulation succeeds in this era.

I'll belabor the point here a little bit. If we allow large operating companies like Enron to interact with large banks like JP Morgan Chase in an unregulated fashion, we will get exactly the financial frauds that we got with those two institutions in 1999, 2000, and 2001. If we allow the large hedge fund community to interact with non-bank providers of credit in an unregulated fashion, we will get the kind of systemic catastrophes that

led policy-makers like Ben Bernanke and Hank Paulson to bail out Bear Stearns when the knew, and admitted, that it was completely contrary to good policy, that Bear Stearns was not an insured entity, that public policy of the United States had never been to bail out broker/dealers, and yet they felt they had no choice.

Unregulated opaque dealings between large institutions are a public problem. The question is whether we will have the political will and the technical skill to regulate them. When the regulatory process began in a serious way, you had a blueprint. The first thing we really had on the table was a blueprint leftover from the Bush administration. That blueprint was drawn up by Paulson and his staff in close consultation with Ben Bernanke's folks at the Fed and released to the public in the spring of 2008. It was a blueprint for trying to build a financial regulatory system – on the model of the FSA, more or less, in the United Kingdom – aimed at weakening, in particular, that part of our regulatory system that is aimed at creating transparency and fair dealing in the securities markets, while strengthening a kind of broadly discretionary regulation of large financial institutions. It was a regulatory model designed to make the world safer for large financial institutions. That model had a strange kind of provenance. It was attacked roundly by a whole lot of people when it came out. Yet there was a feeling that it continued to bubble away alive underneath, that there was considerable intellectual and political continuity in key policy making circles that kept that model alive in the quiet recesses and corners of Washington.

The Congress of the United States in enacting the TARP (Troubled Asset Relief Program) legislation mandated that the Congressional Oversight Panel present Congress with regulatory reform recommendations. They gave us about six weeks to do it, from when we were empanelled, including Thanksgiving and Christmas. But we did manage to get this report out in January of 2009.

Damon Silvers

I am going to summarize what this report said because I think it represents a different approach than the Paulson approach.

We had eight major recommendations, and they will sound familiar to you. First, there needed to be intensified regulation of any financial institution that posed systemic risk. Secondly, there needed to be hard limitations on leverage in American financial institutions. Thirdly, we needed to re-regulate the shadow financial system, with particular emphasis on derivatives, hedge funds and private equity funds, and off-balance sheet financing in banks, with brief reference to tax and regulatory havens. Fourth, there needed to be a new consumer protection agency to consolidate consumer protection in the financial services sector focused on consumer credit and other types of consumer financial products that are essentially unavoidable if you want to be integrated into the American economy. That may sound familiar to you because it has become the center piece of public reform agenda articulated by President Obama. Fifth, there needed to be reform of executive pay in financial institutions around time horizons and risk exposure. Sixth, credit rating agencies needed to be reformed, and something needed to be done about the basic business model of credit rating agencies. Seventh, establishing a global regulatory floor needed to be made a US diplomatic priority. You couldn't really effectively regulate here in the US, not that we shouldn't try; but in the long run it wasn't going to be effective if people could just run away to regulatory havens and continue to participate in our markets and other large national markets around the world. Eighth, we need to plan for the next crisis; we need to have structures for looking over the horizon and around the politics and influence that can tend to dominate regulators in Washington, no matter how well-designed.

Those were our eight recommendations. The promulgation of those recommendations (I am now giving you the history of the effort for strong financial regulatory reform) was followed by the formation of something called Americans for Financial Reform, essentially a broad coalition of groups that do not represent the banking system. The entirety of the labor move-

ment and all of its factions are part of this coalition; the AARP, the Leadership Conference on Civil Rights, the Consumer Federation of America, several hundred community based organizations and housing advocacy and the like. Basically, the constituency base of the Democratic Party is completely within this coalition as near as I can tell. What the coalition did initially was to endorse the regulatory reform recommendations I just went through with you. The second move the coalition made was to digest those down to four priorities. It is the fate of those four priorities I am going to spend the rest of my remarks addressing.

The four priorities were: 1) address the crisis in the mortgage market around foreclosures and around the abuses of consumers and the weakening of civil rights standards; 2) create a consumer financial protection agency; 3) regulate the shadow markets; and 4) establish effective regulation of systemic risk by a fully public body. "Fully public body" is code for the Federal Reserve System in its current form; current governance structure, interpenetrated by the banks themselves, is unfit for that task.

It didn't feel like it was necessary initially, but it has become clear that we need to add a footnote to number four. Panel One talked about this a great deal. The footnote is we can't do bailouts the way TARP was done any more. By that, I mean we cannot bail out the stockholders of financial institutions. No public purpose is served by doing so. The first task in doing a bailout is to figure out which among the creditors of a failing financial institution can be haircut. By the way, this is precisely what occurred in the auto companies. This is what has occurred in every successful bank bailout that the Congressional Oversight Panel reviewed in our April report on historical and international comparisons in financial rescue strategies. It is clear, based on both the drafts of the legislation we have seen and the history of TARP, that if you don't write legislation to make this clear, it will be done over and over and over again.

So, where are we on these four priorities? I think it is a good thing that those four priorities have largely become the structure, the discussion, in financial

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Phil Angelides, Financial Crisis Inquiry Commission

Keynote address



Phil Angelides

I want to talk today, briefly, about the work of the Financial Crisis Inquiry Commission. I want to talk about our role; I want to talk a little bit about how we intend to go about our role, and I want to talk briefly about what we hope to achieve. Let me take about ten to fifteen minutes and then what I'd like to do is, before you go on to your next session, perhaps take some of your questions to see if I can give you some answers about how we see our work.

As Jamie mentioned, the Commission was created in the Mortgage Fraud Recovery Act, passed in May of this year by Congress and signed by the President. The Financial Crisis Inquiry Commission is composed of ten members – six appointed by the Democratic leadership of the Congress, four appointed by the Republican leadership. We are charged with examining the causes of the financial crisis, writing the official history of what brought our financial and economic system to its knees.

We have two very specific charges. One is to look at the overall marketplace and determine the driving forces that led to our financial and economic collapse. We are charged with looking at lending and securitization practices, regulatory actions or inactions, with the global savings imbalance, a whole range of matters, to really look at the large picture.

We are also charged with examining the causes of the collapse of the major financial institutions, or those that would

have collapsed but for extraordinary government assistance. And that, of course, means that we will be looking very specifically at institutions like AIG and Fannie Mae and Freddie Mac and Bear Stearns and Lehman and Citigroup and Goldman Sachs, even though some of them may dispute today whether or not they would have survived without the massive infusion – direct or indirect – into their coffers.

The Commission is really part of a long history in this country of establishing independent commissions on a non-partisan basis to look at events of consequence for our nation. In the financial field, there is a legacy here of independent looks, a step away from the daily combat of politics and official government inquiry, hopefully to help shape policy and reform on a sustained basis going forward. This history reaches as far back as the Aldritch/Vreeland commission in the wake of the 1907 panic that ultimately led, six years later, to the creation of the Federal Reserve System. Of course, the commission that gets the most notoriety is one that had a tremendous impact on our thinking about what our financial system ought to be – the Pecora hearings in the 1930s. They were held by the Senate Banking committee, but named after Ferdinand Pecora, the general counsel to that committee – which always leads me to believe, or question as an elected official, what the heck the chairman of the committee was doing during those hearings. Gettin' up late, perhaps; drinkin' a little early, who knows? But Ferdinand Pecora was of great service to this country because he stripped the veil back on Wall Street. He exposed the American people to a set of practices that when they saw them, the American people decided collectively that they did not want to see them again any time soon in their financial system.

As we begin our work, we take inspiration from what Pecora did, because it was plain and simple. It was an investigation that revealed real practices and real institutions carried out by real people. He marched in National City Bank;

he marched in JP Morgan; he marched in Chase Manhattan; he marched in the New York Stock Exchange. And people saw a set of manipulations that they vowed that they would not see again. For decades we had a steady-state financial system, a balance of both innovation and regulation, which helped this country have a capital system that supplied capital for the creation of enterprises, and value, and job creation, and broadly-shared prosperity.

The other commission from which we take some inspiration is a more recent example, but not in the financial area. That was the 9/11 Commission, a commission born in extraordinary controversy but ultimately a commission with ten members of both parties, who made very clear findings about what happened, what led to our vulnerability to terrorist attack. We all remember, or many of us do of course, in the course of those hearings, hearing some very simple stories that told a larger story about America's unpreparedness: the FBI agents reporting up the chain that there were foreign nationals learning to fly, not land, not take off, big commercial airliners, and no one listening. An August 6 memo going to the President of the United States saying Al Qaeda was committed to strike at this country, and by the way, there would be hijacked airplanes and buildings blown up in New York.

What the 9/11 Commission did was discover and then lay out the facts. And when they laid out the facts the American people came to a conclusion that this country was ill-prepared for the attack when the attack arrived. I hope in the course of our work, if we stay to evidence and if we stay to facts, and we lay out what happened, this story of the collapse of our financial system can be a cautionary tale that will form future judgments going forward.

We are now under way with our work. We've been bringing on our senior staff. Our investigation is rolling forward. We have offices here in DC and New York, and we are in full gear. So now we are going to conduct this inquiry.

Phil Angelides

We've been given, I think, a very critical mission, one that has everlasting impact. Not to say that I see us as so important for the ages, but one that can't be measured on what impact it has today or tomorrow, but for the long term. In fact, some people have asked me, "Since Congress seems to be moving ahead with reforms in the financial system, is the Commission of consequence to the American people?" Here is my answer: True reform does not come with a sweep of legislation alone. A single piece of legislation that creates a new regulatory box, in and of itself, is not enough. If you look back at the New Deal, the New Deal reforms were a product of many years' discussion about what we wanted our financial system to be. I submit to you, we have regulatory bodies today. If we create a new systemic regulator, what's important is how they look at the market place. What's the political will? What's the consensus of this country about the proper function of the financial system? Ultimately, true reform is about cultures and values, about what is considered acceptable and optimal in the marketplace, and also about what commitment you have in the regulatory sector and what capability you have in the regulatory sector.

I believe that this discussion of reform is one that is not about to end but one that is just beginning. We've been given something as a task that's very important, and it's critical that we do it without partisanship of any kind because what has happened here has been of enormous consequence – with consequences both for Americans of all political stripes and, I would submit to you, also with likely culpability of Americans of all political stripes. It's a daunting challenge but I think in the end it's very clear what we are charged with: conducting a full and fair investigation in the best interests of the nation, pursuing the truth, uncovering the facts, and providing an historical accounting of what brought our financial system to its knees. I believe this accounting is desperately needed. The fact is, in the wake of 1929 people were throwing themselves out the windows on Wall Street. This year they're lining up for bonuses.

There has been no serious self-examination on Wall Street of what has occurred and what should be in the future. I liken it to someone who has had a significant heart attack, who is a bad eater, smoker, no exercise. Three weeks later they are feeling better, and the fact is that the fundamental problems still remain. So now, I believe, is the time for self-examination.

Often people talk about the financial crisis as if it's something that just shook the halls or the streets in New York. But in fact, you and I know it's not so much what happened 14 months ago, the freezing of credit in the country, that's

There is a hunger on the part of Americans to know what happened. There is a hunger to hold people accountable. There is a hunger to ensure that the people who acted irresponsibly take responsibility.

truly of consequence. It's really what's happened in the months since then to the American people. Nine million people have lost their jobs since the downturn. Twenty-five million people in this country are out of work, under-employed or have quit looking for work. Two million Americans have lost their homes. Ten million have been in the foreclosure process, and likely many more will face that same consequence. Not to speak of the Americans all over this country who, when they go back to work, go back for significantly lower wages than they earned before. My best friend from elementary school lost his job in the real estate industry. After nine months of not working, at age 56 he now has returned to a job that pays him thirty-two thousand dollars a year, raising with his wife two children on a fifty percent pay cut. This plays out all across this country.

There is a hunger on the part of Americans to know what happened. There is a hunger to hold people accountable. There is a hunger to ensure that the people who acted irresponsibly take responsibility.

Fourteen months ago there was a meltdown in the financial market. Our charge is to take a look at that implosion or explosion and to trace the fuses back to when they were lit and to give the American people the best sense of what occurred. If we do our work right, I think we'll deepen the national dialogue about the need and the shape of reform. At this point, I think it's fair to say, that we haven't had that robust dialogue. We haven't gotten to the heart of what we want our financial system to be. Do we want it to be a system that is in and of itself about making money? Or do we want it to be a capital system that in the end is the driving force that helps create jobs and broadly shared prosperity?

How we do our work will be fundamentally important. First of all, it's important that we proceed on the basis of facts and evidence, and not according to the opinions or political leanings of each of our commissioners. It means that in some thorny areas we will look at the facts. Some of you know there is very robust debate about the sub-prime area. Who led the meltdown? Was it the non-agency, non-regulated mortgage originators and securitizers across this country? Or was it Fannie and Freddie and the Community Reinvestment Act?

I submit to you that the facts will speak for themselves, that if we do our job, we will lay out for people what happened, when it happened and on what magnitude it happened. Secondly, we have an obligation to conduct this investigation with the same seriousness with which the 9/11 Commission conducted their investigation. They held 12 public hearings and we intend to hold public hearings all throughout next year, to lay out for the American people in very clear terms what happened at the institutions that they were called upon to rescue. The 9/11 Commission conducted 1200 interviews, and reviewed over 2.5 million

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Phil Angelides (continued)

pages of documents. I assure you we are going to undertake the same thorough type of examination. And I will say that it's not really our job to engage in public posturing. People want a serious look at this matter. People often ask me, "Are you going to make criminal referrals?" We do have subpoena powers. We do have the right, and the ability and the authority to refer for criminal prosecution.

But I also submit to you that if all we do is find 30 perps and line 'em up against the wall, we will have undersized the story. The truth is, and you and I know this, that much of what happened in the marketplace was not illegal. It was permitted, and not only permitted but exalted and applauded by society. You know, it wasn't many years ago that Enron was America's most admired corporation, where the CFO won CFO of the Year.

As we pursue our work we will pursue the trails of evidence. Our job is not, as we see it, to embarrass people but to produce facts. And if the facts embarrass people so be it. And if in fact they unveil wrongdoing, so be it.

Finally, I think it's important when we undertake our investigation that we do it in a way that's clear and relevant to the public. Wall Street is very adept at making things complex because it's a good way of patting people on the head and saying, "Don't worry, we can handle all this." So CEOs, CLOs, RMBFs, credit default swaps, often things that seem to confuse even the brightest and most

tuned-in of folks – we see our job as not to dumb down this story but to make it understandable, to bring to the American people a set of hearings and a report that they will want to read, that's compelling, that's understandable, and that will engage more Americans in a debate about our financial future.

So what, in the end, do we hope to achieve? There is much anger in this country, and rightfully so. The public's trust in our financial system has been badly shaken. Many Americans who abided by the rules now find themselves out of work, devastated by foreclosures, uncertain of their future prospects. There is a hunger to see that those who profited from irresponsibility take responsibility, for wrongdoers to be held accountable; but I really do believe that the most important thing that we can do is to shed light and not heat, to unveil what happened so that Americans can have a clear understanding of history so we do not repeat it. And what we do is to help foster the kind of deep debate about financial reform this country needs and deserves.

In the wake of the market crash of 1929 there was a whole generation of Americans who would never put their money at risk in what they saw as the casino of the stock market. The Dow Jones Industrials did not exceed its 1929 peak until 1954 – twenty-five years later. We can ill afford a similar, prolonged period of lack of trust. So, we hope that we can be contributors to people knowing more about what happened, contrib-

utors to fostering a deeper dialogue, and contributors to spurring a debate about what's at the core of what's wrong with our financial system today. I don't really believe, and again, I will hold all my judgments until our work is done, that if we'd just passed regulation X or Y that all would have been ok. I really do believe we face a fundamental question of what we want our financial system to be. I hope we can do work that returns our financial system to one that is a supplier of capital for the creation of jobs and wealth for the American people once again. That's my hope as we undertake this work and that's my hope for what our country will grapple with in the months and years ahead.

Thank you so very much for having me here.

Phil Angelides is Chairman of the Financial Crisis Inquiry Commission. Mr. Angelides has earned national acclaim as an effective public and private sector leader with broad expertise and accomplishments in the fields of investor protection, finance, housing, and corporate and financial market reform. He has won widespread praise for his innovative work in urban reinvestment, smart growth and green investment. Mr. Angelides was elected California's State Treasurer, serving from 1999-2007. The Associated Press reported that he made "the sleepy treasurer's office a policy powerhouse," and The Sacramento Bee praised Treasurer Angelides as "the most effective and dynamic state treasurer in a generation."



Damon Silvers (continued from page 3)

reform. I wish I could say that's because of the great influence of the progressive community in America's politics. I think it's actually because these four things are kind of unavoidable. They are the center of the action. The housing market, consumer protection, derivatives and hedge funds, and systemic risk – it's pretty commonly understood that's where the action is.

I think people may be familiar, but I will just review the state of the bidding in terms of the formal regulatory reform process. Last summer the Treasury Department issued a White Paper on regulatory reform. That White Paper included significant positive steps in all four areas. It was strongest in consumer protection and, I would say, most problematic in the area of systemic risk, where it sought to give broad power (effectively to bail out banks using public money) to the Federal Reserve. It was positive in the area of systemic risk in that it envisioned resolution authority that could be used to do bank bailouts the right way. It's been my view, and I think the view of some of the speakers that you've heard from already, that in reality, the government has always had that kind of power even over bank holding companies and non-bank financials. When a firm of that type is in trouble the government has enough leverage to be able to force a restructuring. But it's been the government's position that they don't and that they need those levers. So, getting that type of resolution authority in the administration's proposal, we felt, was a good thing.

We started with the Treasury White Paper and then two legislative processes in parallel started. One is in the House, where the House Financial Services Committee, chaired by Congressman Barney Frank, took up, more or less, the White Paper's agenda in a series of discreet bills marked up in committee one after the other. The design is to combine them all and bring them to the House floor. At the same time, Chris Dodd, chair of the Senate Banking Committee, moved forward on more or less the same broad subject areas but with one consolidated bill. Barney is in the middle of the process I

just described. Chairman Dodd dropped a discussion draft of a comprehensive bill earlier this week. I am going to now review these four areas and what they do in each area.

First in the area of mortgage market regulation – really neither bill addresses it. The issue of relief for homeowners facing foreclosure seems for now to be more or less in the hands of the Treasury Department and programs it has initiated under TARP. The question of whether those programs are going to be adequate is very much open. My own view is that, while well-intentioned and far better than what the Bush administration had done, we still aren't

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[But] it envisioned
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anywhere near addressing the foreclosure problem. In one respect, there is in the mortgage area an important element in the Dodd bill that is not in the Barney bills. The Dodd bill envisions moving authority for enforcing the Community Reinvestment Act from the safety and soundness bank regulators to the new consumer protection agency. In the long run, that is likely to strengthen protections for communities of color faced with exploitive practices in the mortgage markets. But set mortgages aside for the moment.

Second, both committees have brought forward strong bills creating a new consumer protection agency for financial services that will have inspection authority in the banks and rule-mak-

ing authority. These bills do not preempt state and local efforts. These are the key dimensions to creating the consumer protection agency, and it is no accident they are strong in this area. Here is an example where presidential leadership really matters. I am convinced that President Obama views this particular aspect of financial reform as what is most important for his presidency to accomplish. He has communicated clearly both to his administration's economic team and to the leaders in Congress that he wants a strong bill in this area. And, so far, we are getting a strong bill, but it has been tough to get it. The resistance from the banking industry, and through their friends in the Democratic caucus, has been intense and we haven't even yet seen the full battle in the Senate. The key issues here are going to be: will this agency have inspection authority, and will there be pre-emption? Pre-emption is extraordinarily dangerous in the context of the fact that administrations in Washington can become captured. I think we have all learned that. That's consumer protection in a nutshell.

Thirdly, shadow market regulation. Here, unfortunately, the story is not so nice, despite the fact that the administration's White Paper proposed fairly strong regulation of the derivatives markets. The strong regulation was to address what Americans for Financial Reform and the AFL-CIO felt were the three key principles in derivatives regulation. First, make sure that derivatives were regulated by the same regulator that regulates the underlying asset. So, if you are writing a derivative on a public security, the SEC needs to regulate the derivative. If you are writing a derivative tied to a commodity, the CFTC (Commodity Futures Trading Commission) needs to regulate it. That principle is embodied in both bills, more or less. The second idea is that there has to be capital, that if you are going to take risks in the form of derivatives you've got to have capital set aside to cover those risks. That principle, together with the principle of transparency in derivatives transactions – which gets at the

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Damon Silvers (continued from page 7)

extraordinary margins that most of us believe exist in the derivatives business for derivatives dealers (mentioned by Rob Johnson in the prior panel) – that set of ideas was embodied in the notion that derivatives ought to be cleared by a clearinghouse and posted on an exchange. Those propositions have not fared so well in Congress. Both the Financial Services Committee and the Agriculture Committee’s bills (as marked up on derivatives) contain a series of loopholes that basically will exempt the majority of the derivative markets from exchange trading and clearing, from having to have capital requirements in the markets themselves and from any kind of transparency. Democrats in Congress have taken something of a hit in the press for writing those exemptions. Behind that is the persistent rumor that, in fact, the large banks and their law firms more or less drafted those provisions of those bills as they came out of the House. On hedge funds and private equity funds: the Barney Frank bill, which was actually introduced by Representative Kanjorski, provides for the registration of the advisors to these funds (which is an important first step) and requires that registration by both hedge funds and private equity funds. The bill does not do what it should do, which is provide the SEC with the authority to regulate the funds themselves. It does envision that the Federal Reserve and the Systemic Risk Council (which I’ll come to in a moment) could label a hedge fund, or a private equity fund, as a systemically significant financial institution and regulate it directly from a safety and soundness perspective. This regulation provides some basic investor protections, for pension funds and endowments and the like, that invest in those vehicles. It does not really create either transparency into the broader market or an ability on the Commission’s part to regulate their activities in the broader markets, from the perspective of maintaining fair markets for other participants. We have those kinds of rules for mutual funds. Even allowing that we might want to allow hedge funds to behave in ways that might be more aggressive in certain

respects than mutual funds, the idea that there is no jurisdiction over them is deeply troubling. However, this is the one area where Barney’s bill is better than Dodd’s bill – because Dodd’s bill doesn’t include private equity funds in the registration requirement. From the AFL-CIO perspective, that is perhaps this single largest weakness in Dodd’s bill in comparison with Barney’s bill. On derivatives, while Dodd’s bill has some loopholes for what they call end users, it doesn’t have the wide range of loopholes that the House bill has.

Now finally I come to systemic risk. There are two issues with systemic risk; one is the regulation. As I said earlier, the House bill in its current form provides that, while there would be a Systemic Risk Council, that Council would essentially be captive of and staffed by Treasury. The real power to make decisions about whom to bailout and how to

How do you avoid essentially giving the banks the power to bail themselves out with the public’s money?

regulate those who might need to be bailed out would rest, in the first instance, with the Federal Reserve. In the discussion draft, the crafting of the powers for the Fed in its systemic risk capacity left no question that it would be able to undertake pretty much any kind of financial transaction to support a troubled institution. Despite the fact that much of the wording seems to be couched with limitations that would seem to be designed to avoid a repetition of the TARP, in terms of the kinds of abuses that I mentioned earlier, when you actually parse the words in the discussion draft, those limitations evaporate. Chairman Frank has promised that’s going to be fixed in later drafts. But, as of today, I can’t say that that has happened yet. The Dodd bill ensures that systemic risk regulatory power resides in an independent agency with

its own staff, a chair appointed by the President; the regulators sit on the agency, and then there are two further independent presidential appointees to that agency. In my view, that’s a far superior structure to what the House bill has in mind. It steps away entirely from, “What do you do about the interpenetration of the banks and the Fed? How do you avoid essentially giving the banks the power to bail themselves out with the public’s money?” There is a second problem with this, which I alluded to earlier, about whether or not we are really shutting the door to the kind of abusive tactics that we saw in TARP. It’s not clear how different Dodd’s bill is, and we are trying to figure that out right now. It is a very long bill. We are hopeful that, as both Chairman Dodd and Chairman Frank have said that they don’t want any more TARPs, it will be possible to improve the language.

I have described these bills, these two behemoths moving through the committees with the leadership’s backing. In the last few days, something else is happening. Other members of Congress are beginning to introduce bills and amendments that go right at a number of the issues that this group is very interested in, and seem to be creating all sorts of political openings. It is unclear how those things will play. Two examples: in the area of “too big to fail,” Representative Kanjorski, who is the second highest ranking Democrat on the House Financial Services Committee, is proposing a bill that would essentially break up too-big-to-fail institutions and give that power to the systemic risk regulators. Banks are very worried about that. There are a number of bills circulating to implement what Paul Volcker has been calling for (which the AFL-CIO very much supports), which is that we shouldn’t allow depository institutions to engage in proprietary securities and derivatives trading, that having insured institutions having affiliates that do that is just insane. If Paul Volcker says it’s insane and Rich Trumka says it’s insane, it’s probably insane. That’s actually what a swing Senator said about Sarbanes-Oxley, “I got calls from Paul Volcker and Rich Trumka in the same

Damon Silvers (continued)

day. That's a new one on me. If they agree, it's probably a good idea." That was a few years ago. Then you have a bill from Senator Maria Cantwell from Washington, who is one of the leaders of a group of senators that has been very militant on the subject of regulating derivatives. Her bill essentially bans naked derivatives. It bans the taking of positions using the derivatives markets that amount to insurance on a risk that you don't actually have. This is a long-standing principle in insurance law. I can't insure your house or your life. It's weakened a little bit in the area of what they call dead peasant insurance, which is really a noxious thing. This is very fundamental principle in insurance; we don't allow people to do that, because of the drain of assets that the gamble represents, and because the perverse incentives it creates. A marvelous example of the perverse incentives it creates happened in the auto bailout, where the administration wanted to negotiate concessions for bond holders only to discover that many of the bond holders had credit default swaps that paid off 100 cents on the dollar if the auto companies defaulted. So that, in fact, they didn't want to cut a deal. They were not rational actors in relation to the finance of that firm because a default was better for them than a structured settlement. That's an example of why this principle is so important. That bill would wreak a radical change in the derivatives markets and confine them more or less to be a straightforward, wholesale, long-term insurance market. You can imagine that some people are fighting that one pretty hard. But the history of that particular group of Senators is that, around derivatives, they can be very tough. This is the group that effectively bottled up Gary Gensler's nomination until Gary committed that he would get tough on derivatives regulation. I must say that it was sort of a strange interaction, because, so far, no one has been tougher on derivatives regulation. He deserves a lot of credit.

What's going to happen here? I think that we are going to see financial reform pass. I think it is likely that we are going to see a pretty robust consumer protec-

tion agency. I'm not certain about that; there was certainly strong opposition here and there, and we made compromises, but I think we are headed that way. I think it's very unlikely that at the end of the day the House version of systemic risk is going to be enacted, because the depth of suspicion and opposition to giving more power to the Fed in the Senate is very great and bipartisan and from all directions – moderates, conservatives, progressives. That could change were the Fed to do some self-evaluative exercise of the type that SEC has done around Madoff, around the gross failure of bank holding company regulation during the crisis;

[T]he administration wanted to negotiate concessions for bond holders, only to discover that many of the bond holders had credit default swaps that paid off 100 cents on the dollar if the auto companies defaulted.

that might change some people's views of the Fed. Similarly, governance changes that would remove the banks themselves from the control of regional Fed boards might change some people's minds about the governance of the Fed. Certainly it would be of some consequence in the views of the AFL-CIO. It's critical to understand that the Fed's regulatory capacity, which is after all what we are talking about when we talk about systemic risk, resides in the regional banks. It does not reside here in Washington. This is where the macroeconomists and the money supply folks are, the bank regulators and the regional banks working for boards of directors that are actually controlled by the banks themselves. This is particularly true in the New York Fed. That's at the heart of what is wrong with the proposal to give

the Fed the type of systemic risk authority that is in the House bill.

I think there is room for some optimism here, but it's not clear how the final picture will settle out, how these powers will be used. (I am going to bring this back to TARP and then I am going to close.) There is a fundamental problem about regulation. As I said at the beginning, there is the issue of whether we really are going to regulate the interactions of the big players. Right now, political will for serious reform is strongest in the consumer financial protection agency - the interaction of the big players with the weak. That's good but it's insufficient. Political resistance to real reform is strongest in those areas that are most about regulating the activities of powerful players as they deal with each other – derivatives, private equity, hedge funds and the like. So, how that's going to come out is unclear.

It is also unclear whether or not we are going to fundamentally deal with the failed financial business model of the last ten years. This goes to all these issues I just talked about, where there is this tension between the leadership bills and the amendments coming in from the side. Are we building a regulatory system to manage a banking system where four banks are the majority of bank assets? Is our design to maintain and manage that system, or to change it? Are we building a regulatory system to maintain and manage a world in which those very large banks I just mentioned have large proprietary trading desks, taking huge risks in the securities and derivatives markets while they have effectively the majority of insured deposits? Or are we going to change that? Those are the big questions on the table and there are increasingly loud voices saying we should change it.

Back to the Paulson blueprint, looking at the things that are not in the administration's White Paper and the ways in which the White Paper was weakened as it moved through the House, you see the shadow of the Paulson blueprint returning. That political tension is unresolved, and it interacts with the strategy undertaken by this administration and

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Session One - Banks and Regulation

Chaired by Michael Lind



Michael Lind, William Black, Perry Mehrling, Rob Johnson, Stephany Griffith-Jones

The session began with **Michael Lind's** noting that the current banking reform debate is unusual in two respects. Firstly, it is not constricted by a narrow consensus. There has been a willingness to ask a broad range of questions, i.e., what is banking for, what should be the fundamental architecture of national and international financial systems? Secondly, there are no clear-cut partisan lines. Rather than a debate between left and right, it's a debate between the banking industry and its allies in Washington, and outsiders across the political spectrum.

William K. Black started by noting that in any discussion of regulation, the focus should be first on what you shouldn't do. Firstly, you shouldn't try to regulate things that can't be successfully regulated; you should ban them or move them where they aren't going to cause problems. Examples include systemically dangerous institutions - the "too-big-to-fails" and proprietary valuation models like the Basel process.

The second area that needs attention is ideology. Worldwide, regulation fails because those in charge believe it cannot work and is counterproductive. Because of this mythology that private market discipline prevents all fraud and cures itself, we are incapable of learning from crises.

So, to escape the ideological trap, we need to remember that, historically, the leading cause of bank failure has been insider fraud. Dr. Black proposed that

every regulatory agency should include a chief criminologist to work on dismantling criminogenic environments (perverse incentive structures). Criminologists would look for the characteristic, distinctive patterns which indicate bank and accounting fraud. Additionally, regulatory agencies must be professionalized. And we must end the policy domination of economists.

Perry Mehrling addressed several questions. Why did the parallel, shadow banking system crash? What went wrong, and how can we fix it? Have we fixed it? In Dr. Mehrling's opinion, two things broke: the funding system and the risk control system. Beginning in 2007, the funding system for the shadow market began a slow, piece-by-piece meltdown. Asset-backed commercial paper, the repo market, financial commercial paper: one by one they collapsed, until finally we moved the money market onto the balance sheet of the Federal Reserve. The exit strategy for the Fed will involve getting the money market working again, so the Fed no longer has to be an intermediary between parties that used to borrow and lend to each other. The broken risk control system includes credit default swaps, guarantees on super-senior tranches, etc. We have replaced, to some extent, these guarantees with government guarantees. This also involves an exit strategy problem because it is not clear that the private sector should be doing the kind of thing that AIG was doing - writing tail

risk insurance for the system.

From this we should take three lessons: 1) markets and instruments need to be regulated more than do institutions; 2) rampant mis-pricing of funding and risk were the source of the trouble, and must be fixed; 3) derivatives reform and regulation are the sine qua non. If we get that right, we will be ok; if don't, we won't.

Rob Johnson spoke about the relationship between the shadow banking system and the concept of "too-big-to-fail," or too difficult to resolve. After the Great Depression, the US instituted deposit insurance for the liability side of banks' balance sheets and controlled the asset side through regulation. Over time, regulation of the asset side has eroded, but our philosophies are still based on the Depression Era logic. We are now in a place where "too-big-to-fail" undermines the entire structure of our capitalist system. As we wrestle with a solution, it is important to appreciate the complexity of the situation.

First, we need the power to resolve financial holding companies, similar to the system which exists now for banks. However, when an institution is resolved, there is no way to know what the effects on the economy will be, how they are intertwined, or who else is going to be dragged down.

A second dimension has to do with international regimes of resolution. When an international bank is placed in receivership, its web of its exposure

Session One - Banks and Regulation

matrix will cross national, legal boundaries. Dr. Johnson suggests that the WTO should impose a Financial Stability Board-type system across the world.

Third, we need to simplify derivatives. We need real prices and real transactions. This will probably result in 6 – 9 billion dollars less profit for the top five banks. This points up one of the challenges in Washington: any group that stands to lose 9 billion dollars a year has a pretty good lobbying kitty. The recently released Dodd bill has delivered the architecture that will put the industry on hold, and Dr. Johnson predicts we will come back and fight about this again

next year.

Good regulation actually makes a market more competitive, and well-regulated markets attract more investors, said **Stephany Griffith-Jones**. A smaller, simpler industry could also be more efficient, and would of course be easier to regulate. Counter-cyclical regulation would offset boom-bust cycles and reduce damage to the real economy. Dr. Griffith-Jones indicated that the discussion is moving towards a consensus that we need different instruments for different failures of financial markets. For instance, in the case of solvency, both counter-cyclical capital require-

ments and loan provisioning could be used. This counter-cyclical regulation has been quite successful in Spain over the last ten years. Who should this regulation apply to? According to Dr. Griffith-Jones, the best approach is for comprehensive counter-cyclical regulation for all institutions, especially instruments and markets. Finally, very strong global coordination of regulation is necessary to make it effective. We should take up the challenge of moving toward an international regulatory authority. Rather than decreasing national sovereignty, this would pool power to increase control over financial markets.

Session Two - Jobs and Housing

Chaired by Andrew Brimmer



Andrew Brimmer

In his opening remarks, Chair **Andrew Brimmer** reminded the audience that jobs are created in response to the demand for labor, and that the demand for labor is derived from the demand for products and services. In other words, the job market is responsive to economic growth and unemployment is a lagging indicator. Dr. Brimmer asked the panel to address the issue of jobs in the context of the Obama administration programs and proposals.

On the housing issue, **Dean Baker** emphasized that the collapse of the eight trillion dollar housing bubble, even within a beautiful financial system, would

have created a very severe recession. The housing boom was driving the economy both directly and indirectly. When the construction industry collapsed, about three percent of GDP was lost, as well as about six billion in housing bubble wealth-driven consumption. This loss guaranteed a recession. This horrible situation is the result of incredible economic mismanagement. Baker suggested that, as an alternative to foreclosure, people be allowed to stay in their homes as renters. This would have several benefits. It creates stability for neighborhoods, and makes foreclosure a much less attractive option for banks.

The Congressional Budget Office projects that the unemployment rate will stay over 10 percent in 2010, and fall slowly to 9.1 in 2011, and 7.3 percent in 2012. Dr. Baker asserted there are two ways to deal with the jobs issue. Firstly, increase demand through more stimulus activity. Secondly, have everyone work fewer hours; this could be accomplished by providing tax credits for employers. Germany has used this strategy and, even with a steeper recession than in the US, their unemployment rate has held steady. Seventeen states already have some version of shorter work week programs and these programs have kept about 150,000 people employed. There are simple solutions to our current

problems; good governance would keep people in their homes and in their jobs.

Gary Dymski discussed both immediate and long-term structural problems. Short-term problems include job losses, foreclosures, and housing deterioration. Americans are facing a triple whammy: they have lost jobs, located far from homes they can no longer afford, and cities and states are cutting back on public services. These problems are a formula for indefinite stagnation, absent proactive leadership.

Dr. Dymski presented twelve specific proposals for resolving the housing crisis:

1. In addition to mortgage assistance (Home Affordable Modification Program, or HAMP), principal reduction should be adopted.

2. A home mortgage disclosure act to require data reporting for loan modifications will shed light on problems including fair lending problems.

3. Make it easier for owner occupants to buy real-estate-owned (REO) properties.

4. Tenants are innocent victims. Banks must respect federal, state and local tenant protections, and at a minimum give tenants in REO properties the option of renting there, so properties don't sit vacant.

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Session Three - The Dollar

Chaired by Richard Kaufman



Richard Kaufman, Pierre Calame, Jane D'Arista, Jan Kregel

Richard Kaufman opened the session by reviewing the relationship of security and economics. He spoke of the Cold War period, when all policy was viewed through a war prism. After the respite of the peace dividend of the late 90s, today's war issues once again infuse economic policy analysis, directly or indirectly, even in discussing the dollar. According to one school of thought, the dollar's decline is symptomatic of the US decline as a world economic and military power. There are of course other views of the causes and consequences of the decline of the value of the dollar and thoughts on what, if anything, should be done.

Pierre Calame examined the issue of the dollar from the European perspective. Because of the interdependence of China and the US, China has had no choice but to keep buying US Treasury bonds even at a zero interest rate or very close to it. Meanwhile, the G20 has been concentrating mainly on bank regulations and very little attention has been given to the issue of a future international currency. Because the Chinese are obsessed with the risk of a decline in growth, they have kept the yuan anchored to the dollar. This means that the Euro cannot be an alternative international currency. There is also growing suspicion outside the US that the current US government pays too much attention to Wall Street interests and arguments, as if the future of the US economy, society and power is bound solely to its role

of financial superpower. None of the structural problems has been fixed; we need a new, enlarged Bretton Woods. This will require careful preparation and a number of deep conceptual and institutional innovations.

Mr. Calame's agenda proposed five main items for a new Bretton Woods discussion. They are: 1) The stability of the exchange rates between four major regional currencies: the Americas (North and South), Europe (including Russia and Africa), East Asia, South Asia; 2) A regional monetary system in each of these four regions; 3) A new approach for energy and commodity management. Here, two issues must be addressed: the short term stability of energy prices through the creation of global regulating stocks, and a new regime of governance for energy in order to move towards sustainable societies and inter-regional justice; 4) Periodic adjustment of imbalances with institutional coordination under the guidance of the IMF; 5) New regulations for pension funds, orienting them in the direction of long term investment.

Next, **Jane D'Arista** noted that there is already a problem with the dollar – in the monetary system itself. One of the key roles of an international monetary system is to recycle payment imbalances. The current inability of the US to serve as a consumer of last resort means that the system is already in jeopardy. Dr. D'Arista noted that there is an aspect of the international monetary sys-

tem that is seldom written about or taken into account: it generates credit, since it is based on foreign exchange reserves, rather than on a gold-based system. She discussed how the contraction of credit was a major factor in the Depression, and how it is important also to look at both stocks and flows in the foreign exchange reserve system. The tendency has been to focus on flows, knowing that there are deficits to finance in the US. However, many of the problems with the system are on the stock side. For instance, in 2005 when Japanese banks were allowed to lend yen, in order to reduce the Japanese reserve stock, there was an incredible build up of financial sectors around the global economy. Foreign exchange reserves have the virtue of being transactional reserve regimes, thus involving the private sector. Therefore, a crisis in the international system, or with the dollar, is most often triggered by an event in the private financial sector.

Where can the system go, moving forward? One often hears that other currencies will pick up the slack, but Mr. Calame made the point that that will not happen. So the discussion turns to SDR (Special Drawing Rights) as the potential international currency. The problem with SDRs is that they are only capable of transactions between central banks. None of the current proposals overcome this shortcoming. Dr. D'Arista proposed an alternative: an international authority that will sell bonds and require member

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countries to buy those bonds and use them as reserves. The income from the bonds would be used for public purposes, such as development, infrastructure, climate change, etc. The member countries would guarantee the value of the bonds. A new Bretton Woods, as Mr. Calame said, is absolutely essential. We should think not just in financial terms, but also fiscal terms of the global economy and how the new system would balance payment imbalances.

Jan Kregel began with the question, "If you are going to replace the dollar [as global reserve currency], what problem do you think this is going to solve?" If the problem can be identified, one can then identify alternative solutions. One of the complaints is that the large holders of dollar reserves are worried about the value of their holdings. One very large holder of US dollar reserves held agency securities and, when Fannie and Freddie Mac were about to be allowed to collapse, this holder intervened to engineer a US government bailout. Is the US really going to bail out all of the foreign holders of its government securities? Obviously that will not happen, because all that will provide are more dollar bal-

ances. The idea that the international value of dollar holdings is guaranteed, or must be guaranteed by the government, is economic nonsense. It cannot be done.

Perhaps the problem is the volatility of the dollar exchange rate. This volatility is because foreign exchange is an asset class and investors invest in foreign exchange. Secondly, because countries have independent national monetary policies interest rates tend to differ, which also produces instability. A simple solution to this sort of flexibility would be to go back to fixed exchange rates – which nobody seems very interested in doing. Another simple solution to dollar volatility is to remove foreign exchange as an asset class; that is, introduce some sort of international capital controls. The original Bretton Woods system was based on the assumption that most international flows would take place through international institutions like the World Bank. So, this is another alternative that does not require replacing the dollar with something else.

The Triffin Paradox says that any system based on a national currency will conflict with other nations' policies, and

create the necessity for international policy coordination which, by definition, must fail. So, we cannot replace the dollar with any other national currency.

If we remove the dollar as international reserve currency, some other asset must then be created. The dollar is a liability on the US Fed balance sheet, offset by US government debt on the asset side. If everyone moved to an international currency, who would provide the debt? The international government, obviously, which would engage in international expenditure and fiscal policy. There would be unimaginable difficulties in deciding what the international deficit would have to be in order to secure global full employment.

There is a conflict, a trade-off, between currency value and labor value. The problem is to design an international financial system that stabilizes both the value of currency and the level of employment. It's not just about the dollar, or its value, or the value of international dollar holdings. It's a question of the value of the major asset that every country possesses: its labor force and its ability to use the labor force to generate national wealth.

Upcoming Events

January 3 – 5, 2010. **Allied Social Sciences Associations/American Economics Association (ASSA/AEA) meetings**, Atlanta, Georgia. See back page of this newsletter for EPS's events.

January 7, 2010. **Section on Socio-Economics of the Association of American Law Schools Annual Meeting Program**, Hilton New Orleans Riverside. The topic will be Economic Recovery and the Obama Presidency. For more information on the Section on Socio-Economics program, email socioeconomics@aol.com.

January 11 – 13, 2010. An international **Meeting on Conflict Management, Peace Economics and Peace Science** at Indira Gandhi National Open University, New Delhi, India. If interested please contact Manas Chatterji, mchatter@binghamton.edu, as soon as possible.

February 1 – 2, 2010. The **Global Costs of Conflict International Research Workshop** hosted by The German Institute for Economic Research (DIW Berlin) and the Households in Conflict Network (HiCN) in Berlin. http://www.diw.de/en/diw_01.c.342818.en/publications_and_events/the_global_costs_of_conflict.html.

February 26 – 28, 2010. The **Eastern Economic Association annual meeting** in Philadelphia, PA. Abstracts and papers should be submitted online at the association's conference homepage: www.ramapo.edu/eea/2010.

June 17 – 18, 2010. **14th Annual International Conference on Economics and Security**, at Izmir University of Economics, Turkey. Sponsored by EPS-UK, Izmir University of Economics, Middle East Technical University (METU), and University of the West of England, Bristol. See <http://ekolider.ieu.edu.tr/eab/DEFENCE2010/> for information.

Session Two - Jobs and Housing (continued from page 11)



Dean Baker and Gary Dymski

5. A large expansion in vouchers for affordable housing for lower-income households under the United States' Housing Choice Voucher (Section 8) program should be approved.

6. Home properties held off the market by banks for more than 60 days should be registered and used in the Housing Choice Voucher Program.

7. A planning and construction initiative be undertaken to increase the supply of housing for lower-income people, to end homelessness.

8. A national Housing-for-America program should be developed, drawing on (and learning from) the Teach-for-America and VISTA programs.

9. One focus of these housing construction efforts should be re-engineering of existing, unoccupied homes.

10. One special challenge with this area is widespread NIMBY (not-in-my-backyard) dynamics. These can block those who have lost housing from regaining it. The government should experiment with incentives to persuade localities to accept Housing-for-America projects and more lower-income housing.

11. Banks are heavily subsidized and supported by the taxpayer public. In exchange, they should meet the credit and banking needs of their entire market areas, not just those of their upscale customers.

12. Finally, as emphasized above, housing fixes are not enough. People need income to maintain their homes, and that means attacking the jobs famine directly, as well as through housing-construction initiatives.

Sherle Schwenninger opened by saying that jobs and job creation are essential to moving forward in the housing crisis. Mr. Schwenninger outlined why the Obama administration has fallen short on job creation.

The first problem was the already broken private sector job machine. This must be taken into account when designing an appropriate response program.

Secondly, the combined effect of the three trillion dollar expansion of the Fed balance sheet, and the economic recovery program of \$787 billion, had a disproportionate result – namely, reflation of the pre-crisis jobless economy. We failed to rebuild a job-creating economy.

Thirdly, a lot of the recovery has gone to general demand support, which may create jobs in a 15 - 20 year time frame. We have under-invested in the more specific demand sectors that would have created more immediate jobs.

Mr. Schwenninger made three recommendations:

1. The private sector job machine is limited, so public sector employment must play a bigger role in the future;

2. We must encourage new sectors of the economy, which will require specific demand-oriented programs, and a major public infrastructure and investment program to jump-start private sector job creation; and

3. We have to think about the supply side (even if this is uncomfortable for liberals and progressives). We need to complement demand creation and public sector employment with payroll tax cuts and corporate income tax cuts to make it more attractive for businesses to create jobs here in the US, as opposed to going offshore.



Sherle Schwenninger

Damon Silvers (continued from page 9)

the last one in TARP. The strategy that TARP has been about is buying time and trying to maintain asset prices within the financial system. That has been a disappointment to the banks, which I think wish to be straight-up rescued. The original idea of buying up assets at inflated prices has been a disappointment to them because it hasn't really happened. It has been a disappointment to those of us who thought that there was a pretty well-established model for dealing with banking crises. People like Simon Johnson have laid it out. It goes back to the Reconstruction Finance Corporation. There are a lot of conservatives who were for it actually. There is an established model of doing this. It involves firing the executive who caused the mess, doing an accurate write-down of the assets, and, to the extent you put public money in, taking full value in terms of bank upside for every public dollar you put in.

Neither of those things has happened. Instead, there has been this time-buying exercise. A serious re-regulatory effort around issues like, for example, propri-

etary trading – separating that from commercial banking – might not be compatible with the time-buying exercise, just as a serious effort to deal with foreclosures might not be compatible with the time-buying exercise. On the other hand, the time-buying exercise may not be compatible either with the long-term health of the US economy and the world financial system. Nor may it be compatible with the short-term needs (of our country and this administration) to address the pressing crises of real people in the areas of unemployment and housing.

How this all gets sorted out in the next six months seems to me critical for the question of the fate of the Obama administration and the hopes for progressive policy direction in our country going forward. Because, fundamentally, I believe the voters are going to be asking three economic questions. The first one is, "When I go to the polls, am I afraid of losing my job or have I lost my job?" The second question is, "Have the people and the institutions who caused this mess been held accountable, or have I (the voter) rescued them?" And

the third question is, "Have we fixed this so we don't do it again?"

Those questions are open questions – each one of them today. If they are answered properly, as, to be blunt, Franklin Roosevelt answered them properly, then I think there is a great future for this administration and for the values it represents, which I think are the best values of our society. If they are answered wrong, the best we can hope for is a re-do of the domestic policy paralysis of the Clinton administration. And there are a number of worse scenarios beyond that.

Damon Silvers is an Associate General Counsel for the AFL-CIO. He was Chair of the Competition Subcommittee of the United States Treasury Department Advisory Committee on the Auditing Profession and a member of the United States Treasury Department Investor's Practice Committee of the President's Working Group on Financial Markets. He is a member of the Public Company Accounting Oversight Board Standing Advisory Group and the Financial Accounting Standards Board User Advisory Council.

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EPS at the AEA/ASSA Meetings

All EPS events at the AEA/ASSA (American Economics Association/Allied Social Sciences Associations) 2010 meetings will be held Monday, January 4 in the Hilton Atlanta

EPS Dinner Honoring Andrew Brimmer
January 4, 6:30pm, Hilton Atlanta, Grand Ballroom B

Host committee chair: Allen Sinai.
 Host committee: Sven Arndt, Alan Blinder, James A. Brox, George von Furstenberg, James K. Galbraith, Michael Intriligator, Jeff Madrick, Alice Rivlin, Ralph Schlosstein, James A. Wilcox

Tickets are \$75; \$50 for EPS members who register by December 18;
 \$20 for students

To register, please email Thea Harvey: theaharvey@epsusa.org

January 4, 8:00am, Hilton Atlanta, Grand Salon B**Session One: Global Financial Crises: Past, Present and Future****Chair: Allen Sinai**

Michael Intriligator, UCLA and Milken Institute, "The Financial Crisis of 2007-09: Causes, Consequences, Lessons"

Simon Johnson, MIT, "Global Financial Crisis: Over, or Just Beginning?"

Allen Sinai, Decision Economics, Inc., "Financial Crises in Historical Context and Future Prospects"

Joseph Stiglitz, Columbia University, "What Went Wrong and What Can Go Right?"

January 4, 2:30pm, Hilton Atlanta, Room 201**Session Two: Planning and Designing a Sustainable Economic Future****Chair: Michael Intriligator**

Andrew Brimmer, Brimmer & Co.

Woodrow W. Clark, Clark Strategic Partners, UN Intergovernmental Panel on Climate Change

Eban Goodstein, Bard Center for Environmental Policy

Clark Abt, Brandeis University

A complete (preliminary) program of the conference is online:
<http://www.aeaweb.org/aea/conference/program/preliminary.php>

EPS Quarterly

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