US Treasury plan shields Wall Street speculators

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US Treasury Secretary Henry Paulson on Monday presented a broad plan to revamp the American financial regulatory system. The proposal, while giving the Federal Reserve Board expanded trouble-shooting powers over financial markets and institutions, would actually weaken federal oversight of Wall Street investment banks and leave virtually untouched the vast, unregulated secondary, or “derivatives,” markets.

Speaking barely two weeks after the Fed intervened to prevent the bankruptcy of the investment bank Bear Stearns and announced massive loans to other Wall Street firms to avert a meltdown of the financial system, Paulson’s “Blueprint for Financial Regulatory Reform” underscores the determination of the most powerful sections of the financial establishment to block any measures that would limit their ability to generate profits and multi-million-dollar compensation packages from various forms of financial speculation.

Paulson largely cast the proposal as a response to the bursting of the US housing bubble and the subprime mortgage crisis that have resulted in tens of billions of dollars in losses for major banks and a crisis of confidence in the entire US credit system. In fact, his department began drafting the plan last spring as a proposal to further deregulate the American financial system and make it even more profitable and more competitive against foreign rivals in Europe and elsewhere.

Paulson, a former Nixon aide and Wall Street executive, has long advocated further moves to limit government regulation of the banks and financial houses. He was the CEO of Goldman Sachs, the biggest US investment bank, before taking over as Bush’s treasury secretary in 2006, and personally benefited from the fast-and-loose risk-taking on Wall Street that was encouraged under both Republican and Democratic administrations. His compensation package, according to reports, was $37 million in 2005 and $16.4 million projected for 2006. His net worth has been estimated at over $700 million.

Not surprisingly, neither in Paulson’s remarks nor in the 214 pages of the plan he released is there any suggestion that Wall Street firms or their top executives be called to account and held legally culpable for the economic and social disaster that has resulted from their reckless and often deceptive, if not outright illegal, policies and actions.

Paulson’s remarks contained the typical euphemisms employed to mask the depth of the economic crisis. “Markets are pricing and reassessing risk,” he said, referring to the collapse of the massively inflated values of securities backed by subprime mortgages and other forms of speculation.

He sought to reassure Wall Street by declaring, “I am not suggesting that more regulation is the answer,” and hailed the repeal in 1999 of the Glass-Steagall Act as a great advance. Glass-Steagall, passed at the height of the Great Depression in 1933 in response to revelations of swindling and fraud by major banks and financial houses, made it illegal for a commercial bank, which accepts deposits from individuals, to also function as an investment bank. The removal of this restriction contributed to the super-heated speculative environment that led to the current financial crisis.

He also declared, “I do not believe it is fair or accurate to blame our regulatory structure for the current market turmoil.” This “blameless” structure allowed, for example, credit-rating agencies, paid by financial firms to rate securities issued by the same firms, to give AAA ratings to subprime-backed debt, and accounting firms to allow mortgage lenders to book losses as profits.

The Treasury Department blueprint is divided into proposals for the near, medium and long term. In the near-term, it calls for an expansion of the authority and membership of the President's Working Group on Financial Markets, which was initiated following the stock market crash of 1987 and presently includes the chairman of the Federal Reserve Board, the treasury secretary, the head of the Securities and Exchange Commission and the head of the Commodity Futures Trading Commission.

The plan also calls for the establishment of a Mortgage Origination Commission to increase federal oversight over the licensing and conduct of mortgage brokers.

Intermediate-term recommendations include greater Federal Reserve oversight of US payment and settlement systems, and the merger of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). This latter proposal would effectively lessen federal oversight of stock, bond and commodities exchanges as well as investment banks, since the more lax procedures of the CFTC would prevail.

The plan also calls for measures to increase federal oversight of insurance companies and closing down of the Office of Thrift Supervision, which presently oversees savings and loans institutions.

In the longer-term, which Paulson acknowledged would take years to carry through, the Treasury plan envisions a tri-partite federal regulatory system, with the Fed largely stripped of its current day-to-day oversight of commercial banks and instead given expanded powers to trouble-shoot over the entire array of financial institutions and markets. Under the Treasury plan, the Fed could inspect the books of any bank, investment bank, hedge fund, private equity firm or insurance company and order remedial action—such as greater capital reserves—but only if the Fed deemed the practices of the company in question to pose a "systemic threat" to the financial system.

The Fed's current role in overseeing commercial banks and other depository institutions would be taken over by a new Prudential Financial Regulator. Significantly, the mandate of this new agency would not extend to investment banks, even though investment banks have now been given access to government-backed loans at the Fed's discount window.

Finally, there would be a Conduct of Business Regulator to oversee the conduct of financial firms to protect consumers and investors.

The immense growth of the American financial sector over the past several decades was fueled by a series of asset bubbles and made possible by the US dollar's preeminent role in the structure of world capitalism, which allowed the US to run deficits and accumulate imbalances of a size unthinkable in any other country. But the period in which the US ruling elite could rack up profits while letting its infrastructure and productive capacity crumble was by its very nature transitory. The current crisis represents the beginnings of a global readjustment and the formation of a new balance of economic power, to the detriment of American capitalism.

The current crisis is the culmination of a protracted decline in the global economic position of American capitalism, partially masked in the past by a vast growth of financial speculation and parasitism. It is not, as Paulson said in his remarks on Monday, merely one of the "periods of market stress" that recur "every five to ten years."