Obama administration calls for changes in financial regulation

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US Treasury Secretary Timothy Geithner testified Thursday before the House Financial Services Committee to promote the Obama administration's proposals for changes in the financial regulatory system.

Calling for "comprehensive reform," Geithner said that the US financial system needed "not modest repairs at the margin, but new rules of the game." In fact, his proposals fell far short of a structural reform of the US banking and government regulatory system.

Despite a collapse of historic proportions caused in large measure by the speculative activities of virtually unregulated banks and finance houses, there was no suggestion of a return to the limited restrictions on Wall Street imposed in the 1930s. These have been systematically dismantled over the past three decades, under Democratic as well as Republican administrations.

While Geithner's proposal was decidedly skimpy on details, he made two main points. First, he said that the federal government needed a more systematic method to deal with large financial institutions that run aground. Second, he argued for a more streamlined and unified regulatory structure, with a single oversight body for all firms—whether banks, hedge funds or private equity firms—deemed "too big to fail."

Geithner's proposal would require large hedge funds, private equity firms and venture capital funds to file with the Securities and Exchange Commission (SEC), providing the government (but not the public) with information about their balance sheets. "Systemically important" financial institutions—whether banks or not—would be required to hold minimum amounts of capital and liquid assets. In exchange for accepting some degree of regulation and supervision, hedge funds and other non-bank financial institutions would receive institutionalized coverage by the government in the event of a crisis.

Geithner, along with Federal Reserve Chairman Ben Bernanke and President Obama and other administration officials, has argued that the collapse of non-bank firms like the insurance giant American International Group (AIG) and the mortgage finance companies Fannie Mae and Freddie Mac could have either been avoided or handled at less cost to the taxpayer had a system been in place for the government to seize large non-bank firms similar to the oversight exercised by the Federal Deposit Insurance Company (FDIC) over depository banks and thrifts.

The basic claim is that the Wall Street collapse was mainly the result of loopholes and anomalies in the government regulatory system. This is fraudulent.

In reality, the Federal Reserve Board, the SEC, the FDIC and other federal bodies were not only fully aware of the reckless and semi-criminal activities of major banks and finance houses, they were complicit in them. They oversaw a financial system that had become wedded to the most parasitic and socially destructive forms of financial manipulation.

Nothing in what Geithner and the Obama administration are now proposing will change that. The basic idea is first, to pump as many trillions of dollars of public money into the banks as are necessary to secure the interests of the bankers and big shareholders and, hopefully, stabilize the firms, and then make certain minimal increments in government oversight so as to contain the fallout when the banks' speculative bets result in more failures in the future.

The so-called shadow banking system is to continue, but its functioning is to be improved so as to better insure the profits of the speculators. For example, the

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intricate network of bets on the credit-worthiness of companies known as "credit default swaps" and "derivatives"—in which AIG was heavily involved—will not be abolished. Rather, its functioning is to be improved by setting up some kind of "clearing house" to manage the massive gambling.

In his testimony, Geithner set the tone early on. He defended the "essential and basic function" of the US financial system, which he said aims to "transform the earnings and savings of American workers into the loans that finance a home, a new car or a college education" and to "allocate savings and investment to their most productive uses."

The American financial system fulfills these requirements "better than any other financial system in the world" and has been a "tremendous asset for the American economy," he declared. But it "failed in basic, fundamental ways," when "innovation and complexity overwhelmed the checks and balances in the system." Hence the "checks and balances"—the regulatory system—are in need of an overhaul.

These remarks make Geithner's position clear: The overall model of American finance, despite certain deficiencies, is viable. It is regulation that should be updated to keep up with the financial system, not the financial system that is to be reigned in by regulation.

The reality is that the "value creation" of most financial growth of the past several decades has been based on the accumulation of paper values, divorced from—and destructive of—the development of society's productive forces.

The collapse of asset values—some $50 trillion since the crisis began—was the reassertion of the law that the value of financial assets must be based on real value embodied in real and socially useful goods.

Geithner's proposal paints a vivid picture of the Obama administration: unimaginative, assaulted from all sides by a crisis for which it has no solution, mired in narrow national interests and, most of all, tied hand and foot to Wall Street.

To the extent that "international cooperation" was mentioned by Geithner, it was to place the onus on the governments of other countries. A nationalist policy, under the guise of "making sure other countries have equal standards," emerged clearly in his testimony.

Some Republican congressmen on the committee grumbled about how much money was being put at the disposal of the banks. Spencer Bachus, a Republican from Alabama, asked if there was any way of handling the crisis without giving banks a blank check. When Geithener answered that, in effect, there wasn't, Bachus merely muttered that "the language of ‘such sums as are necessary' seems too open-ended." He spent the rest of his remarks denouncing the fact that part of the bailout money found its way to foreign banks.

The next questioner, Democrat Joseph Donnelly from Indiana, asked whether banks' failed investments "provided value-added, or was this just gambling?" After equivocating for a moment, Geithner said, "It's too hard to separate a legitimate hedge with economic value...from pure speculative bet."

"But we have been forced to take money from our waitresses' pockets, our truck drivers' pockets...to pay off bets on Wall Street," Donnelley replied, asking whether it was possible to take any action to limit speculation.

"The essential thing is to make sure there is more capital held against those sorts of decisions," said Geithner, referring to speculative bets. "It's too hard to ban particular financial instruments altogether." Having asked his token question, Donnelley seemed satisfied.

Al Green, a liberal Democratic congressman from Texas, fell all over himself in praise of Geithner's proposal, claiming that it would "keep the wolves out of the henhouse." After quoting Martin Luther King profusely, Green closed his remarks with the words: "Mr. Secretary, I salute you for what you're doing. God bless you."

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