

Never Let a Crisis Go to Waste: the Obama Administration aligns with Simon Johnson's article The Quiet Coup, plans to use crisis to break the oligarchy and fix the system

By Amy Solomon

Abstract: In his article The Quiet Coup, Simon Johnson makes the case that the Obama administration must “break the financial oligarchy that is blocking essential reform” before our nation can recover from our current catastrophic downturn. Johnson and the Obama administration agree that a blind faith in Wall Street and subsequent lack of regulation of it have led us to where we are, and the only way to dig ourselves out of this avoidable recession is to wipe out the elite and overhaul what brought us here; which is, in large part, the financial regulatory system. Johnson, former chief of the IMF, argues that the administration must act swiftly and with great pressure on the “oligarchy” (which in our case is comprised of the financiers), but believes that “the principal characteristics of the government’s response to the crisis have been delay, lack of transparency, and an unwillingness to upset the financial sector.” While the administration understands that they need to move quickly in order to “not let a serious crisis go to waste” as Rahm Emanuel stated, it is unclear as of now if they’re acting as quickly as Johnson believes they need to. Obama has spoken eloquently, and frequently, about laying down new rules for Wall Street (and the oligarchy), and doing it as soon as possible: but he doesn’t have many details to back up this claim yet. The only concrete plan proposed by the administration so far is of derivatives, which was announced in May. While de-regulation of derivatives was an important step in our downfall to this current crisis, much more than that regulation needs to be acted upon. The administration has promised a “completely overhaul” within the next couple of weeks, and hopes to have Congress working on it by fall. Until this plan comes out, we won’t be able to tell if Obama is gutsy enough to be as tough on Wall Street as Johnson says he needs to be.

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In his article The Quiet Coup, Simon Johnson, former chief of the IMF, explains how the United States brought about our current global downturn, citing lightweight regulation due to the boom that the financial industry exhibited over the past 25 years. As everyone got richer with the innovation of more fancy financial tools and mounting opportunities for financiers to make a lot of money, no one had the incentive to question what was going on¹. This blind faith in Wall Street and lack of monitoring has led us to where we are now, in the depths of an avoidable, yet horrendous recession. Johnson makes the claim that in order for the United States to be able to recover, it has to “break the financial oligarchy that is blocking essential reform.”² He states that the United States’ situation is comparable to that of an emerging market economy in crisis, where the elite have to take a hit before progress can occur. But eventually, the U.S.’s situation differs from the emerging-market analogy. Johnson points out that while other countries would just eventually run out of currency, the U.S. has the ability to just keep printing it. Due to this ability, the United States could suffer through this downturn for years without actually taking any action to combat it, and this worries Johnson. Because the industry in question is so important to our economy and the global one, action must be taken, and soon. Johnson and the Obama administration agree that Wall Street should not be allowed to continue its wheeling and dealing that has put the entire global economy in jeopardy.

¹ Johnson, Simon. "The Quiet Coup." The Atlantic May 2009 Johnson, Simon. "The Quiet Coup." The Atlantic May 2009

² Johnson, Simon. "The Quiet Coup." The Atlantic May 2009

The best way for the administration to fix our financial sector is through regulation, the lack of which has brought us into this mess. President Obama said in a speech at Georgetown, "It is time to lay down tough new rules of the road for Wall Street to ensure that we never find ourselves here again."³ Obama and Treasury Secretary Geithner have begun to lay down the law for a complete overhaul of the financial system, something the public and economists alike all agree needs to happen. With everyone's support behind the total reform, the big issue isn't whether or not to do it: what's up for debate is *how* should we do it, and *when*.

Johnson argues that "the principal characteristics of the government's response to the crisis have been delay, lack of transparency, and an unwillingness to upset the financial sector."⁴ The new administration claims to be moving at the fastest speed possible, already having proposed a plan for the derivatives market and a broad outline of the ultimate overhaul, but has been slowed down by the chaos that is the currently entrenched regulatory system. Obama has made it clear that he intends to break what Johnson calls the oligarchy, but he doesn't have detailed plans yet to back it up. But the administration does agree with Johnson; in order to break the oligarchy, the regulation must come fast and hard, or we'll rebound and the shadow banking system will be allowed back before we can combat it. In an interview with the Wall Street Journal, White House Chief of Staff Rahm Emanuel said that "You never want a serious crisis to go to waste,"⁵ and that the administration plans to take advantage of it in order to fix the system. In order to fix it, the administration has to be willing to strip those elites who got us in this recession of their power, and to consolidate the regulatory system that was key to our downfall. This paper will attempt to explain how the regulatory system got to where it is, how the administration has so far attempted to break the oligarchy, and what hasn't been done yet but still needs to happen to get us out of regulatory mess.

Our Current Regulatory System

The age of the banking oligarch (as Johnson would call it) that we just witnessed isn't the first one in the United States' history. The previous was in the 1930s, just before the stock market crash and Great Depression. The age of those banking oligarchs ended with heavy a heavy regulatory framework that survived 60 years until serious deregulation was enacted by more recent administrations. The regulation that came out of the Great Depression included the Glass-Steagall Act, and the creation of the Federal Deposit Insurance Corporation (FDIC) and Securities and Exchange Commission (SEC) that still exist today⁶. The strength of this regulation lasted until our recent reemergence of the allure of the financial sector. Deregulation of the financial sector that began in the 1970s slowly led to the crisis of 2008, and now we need the same kind of strong regulation that came out of the Great Depression. Alan S. Blinder has called for "A New Financial Deal," like the one that FDR brought us: but this time, it's more difficult. Because there was no regulatory precedent before the Great Depression, policymakers got to start from scratch with reform. Now, there are so many entrenched agencies that it's hard to know even where to begin, and there are so many congressmen and politicians who don't want to see a particularly agency go that it's nearly impossible to work through it all. Right now, the regulatory system has many loopholes in it, through which the current downturn slipped. Geithner has said that "This financial crisis was caused in large part by significant gaps in the oversights of

³ Rampell, Catherine. "The Post-Recession Appetite for Risk and Regulation." Weblog post. [Economix](http://economix.blogs.nytimes.com). 15 Apr. 2009. 20 May 2009 <economix.blogs.nytimes.com>

⁴ Johnson, Simon. "The Quiet Coup." [The Atlantic](http://www.theatlantic.com) May 2009 Johnson, Simon. "The Quiet Coup." [The Atlantic](http://www.theatlantic.com) May 2009

⁵ [Video: Never Let a Crisis Go to Waste](http://www.youtube.com/watch?v=...), WSJ November 19th, 2008

⁶ Blinder, Alan S. "The Case for a New Deal." [The New York Times](http://www.nytimes.com) 4 May 2009

markets,” and he recognizes that we need to fill those gaps. Because banks and institutions are allowed to “shop for a regulator,” they all look for the one with the loosest rules that will allow them to seek the most profit with minimal monitoring. Marc Lackritz, who just retired as president of the Securities Industry Association, said that the “Overall landscape [of the regulatory system] makes zero sense. It’s outmoded.”⁷ Newsweek has described it as an “alphabet soup of regulators,” including the SEC, OCC, CFTC, and OTS just to name a few.⁸ “Turf battles” among the many agencies have contributed to significant neglect of markets by overseers.⁹ Wall Street’s biggest firms find crafty ways into shady cracks between these regulators, and many of the regulators themselves are weak. A.I.G. has shone a spotlight on this, when it decided to take its regulation from the Office of Thrift Supervision, a tiny regulator (watching the giant is AIG). Just because AIG bought a small savings and loan at one point in time, the rules of the system allowed them to place themselves under the OTS’ supervision, and a whole unit went unregulated, resulting in credit default swaps being sold worldwide.¹⁰ Secretary of the Treasury Tim Geithner has said that “our regulatory system failed to adapt to the emergence of new risks. The current financial crisis has exposed a number of deficiencies in our federal regulatory system,”¹¹ and those deficiencies that’s he talking about are the loopholes that we need to fix. Everyone agrees with Geithner when he says, “We need a much simpler financial oversight structure. It’s not going to be comfortable for everybody but it’s important to do.”¹² That discomfort is what will break the oligarchy, and bring us out of this downturn.

The most difficult part of breaking the oligarchy through regulation is working through the mess that is our current regulatory system. We have to consolidate the system and specify who *exactly* regulates what, and put an end to the “race to the bottom,” and “regulatory arbitrage.” Policymakers in the United States have been struggling with how to fix this regulatory mess for over a year, and Secretary Paulson had proposed a re-vamping last March that included an across-the board consolidation of banking and financial agencies. Paulson’s idea is not currently included in Geithner’s plan, which could prove to be a problem if it is missing when the plan’s details emerge. But before we can consolidate, we have to figure out **who** will regulate, **what** they’ll regulate, and **when** they will.

What Obama has done so far

Since the campaign trail, Obama has promised an overhaul of the financial regulatory system. Soon after his inauguration, Obama told the public that he would move very quickly to tighten the system, and as more time passes, more broad outlines emerge. All of the broad outlines that have come out have contained the same ideas; tighter regulation of hedge funds, mortgage brokers, executive compensation, exotic financial instruments (derivatives, etc.) more government power to regulate big financial institutions, and more. Ben Bernanke stated that “Our regulatory system must include the capacity to monitor, assess, and, if necessary, address potential systemic risks within the financial

⁷ Hirsh, Michael. "Wall Street's New Game." Newsweek 15 May 2009. 20 May 2009
<<http://newsweek.com/id/197825/output/print>

⁸ Hirsh, Michael. "Wall Street's New Game." Newsweek 15 May 2009. 20 May 2009
<<http://newsweek.com/id/197825/output/print>

⁹ Labaton, Stephen, and Jackie Calmes. "Obama Proposes a First Overhaul of Finance Rules." The New York Times 14 May 2009

¹⁰ Hirsh, Michael. "Wall Street's New Game." Newsweek 15 May 2009. 20 May 2009
<<http://newsweek.com/id/197825/output/print>

¹¹ Labaton, Stephen. "Obama Plans Fast Action to Tighten Financial Rules." The New York Times 25 Jan. 2009.

¹² Labaton, Stephen, and Jackie Calmes. "Obama Proposes a First Overhaul of Finance Rules." The New York Times 14 May 2009

system.”¹³ Obama has promised that his complete overhaul of the system will definitely include this, and promises this overhaul within the “next couple of weeks.” The first actual action Obama took in terms of regulation was in May, when he sought new authority over derivatives, complicated financial tools. Derivatives have gone un-monitored for decades, but the new proposal says it will force the tools, which include credit default swaps, into the open by trading them on clearinghouses or exchanges that would make them more transparent and more easily regulated.

Obama must move quickly

Despite his progress on regulation of derivatives and his promise of an upcoming complete overhaul of the financial system, Simon Johnson and many policymakers (including many in Congress) don't feel Obama is moving fast enough in this regard. They argue that this change cannot wait for the economy to recover, and in fact if it does, the change won't be able to happen. Rahm Emanuel has argued that the administration understands that the crisis must be taken advantage of in order to reform things that “you think you could not do before.”¹⁴ But as Wall Street gets increasingly healthier, it becomes less likely that Congress or the Treasury will be able to get enough people to rally behind the idea of breaking through the oligarchy and “vested interests.”¹⁵ As Geithner has said, “You want to move at the point where people still have the memory of the trauma.”¹⁶ If the economy rebounds too much before enough regulation gets done, the strong desire to finally reform the system and the apparent deficiencies will disappear with the emergence of the joy of a healthier financial industry. If the reform doesn't happen while Wall Street is down and being criticized, the financiers who got us into this mess will just escape right back out of it, and go back to their financial toys and excessive risk that we hope to break with the oligarchy, and everything will go back to how it was. The Obama administration insists that it is rushing to finish the proposal for the overhaul, and they want Congress to get their hands on it by fall¹⁷, but they should move as quickly as possible in order to take advantage of the opportunity for reform the crisis has provided them with. Obama said “one of the messages that I want to send is that, as we get out of this crisis, as we work towards getting ourselves out of recession, I hope that Wall Street and the marketplace don't think that we can return to business as usual.”¹⁸ Obama can't just send messages for this to happen; he has to make it literally impossible for the oligarchy to go back to business as usual, and he can do that through tough regulation.

What the impending overhaul should look like

There are many different types of regulation that need to be a part of Obama's final proposal for re-structuring the regulatory system that he presents to Congress. As previously mentioned, the proposal needs to figure out how best to oversee the entire system, which should mean a consolidation. This could mean an expansion in the Federal Reserve's power, or even the creation of new, powerful agencies. The plan should include newer, tougher federal standards for mortgage brokers, in order to

¹³ Feisenthal, Mark. "Bernanke says stress tests could guide rules overhaul." Ed. Andrea Ricci. [Yahoo! Finance](#) 7 May 2009

¹⁴ [Video: Never Let a Crisis Go to Waste](#), WSJ November 19th, 2008

¹⁵ Hirsh, Michael. "Wall Street's New Game." [Newsweek](#) 15 May 2009. 20 May 2009
<<http://newsweek.com/id/197825/output/print>

¹⁶ Calmes, Jackie. "Geithner Opposes Caps on Executive Pay." Weblog post. [The Caucus: The Politics and Government Blog of The Times](#). 18 May 2009. 20 May 2009 <thecaucus.blogs.nytimes.com>

¹⁷ "Reshaping Financial Oversight." [The Wall Street Journal](#) 28 May 2009

¹⁸ Tozzi, Lisa. "Obama Criticizes A.I.G. Bonuses, Calls for Greater Regulation." Weblog post. [The Caucus: The Politics and Government Blog of The Times](#). 18 Mar. 2009. 20 May 2009 <thecaucus.blogs.nytimes.com>

fix the peddling of bad loans that played such a key role in this crisis. The regulation of hedge funds should be tightened; instead of voluntary registration with a regulatory agency, careful monitoring should be regular and required. Oversight of executive pay must increase with this new proposal, and a good way to align incentives of the oligarchs with the interests of the corporation would be to tie compensation to performance¹⁹. The issue of extremely high leverage must also be fixed: Bear Stearns died with leverage of 33 to 1²⁰, which signals that we need a more moderate ratio. Rating agencies have made a good faith effort so far to change for the better, but still face an incentive issue when they get paid by the issuers of the very securities that they are supposed to rate²¹. The government needs to have the power to intervene with troubled institutions when necessary, and look carefully at the strategies of important boardrooms. Obviously, this is a lot on Obama's plate, but there's no better time to do it, and it has to be done before the opportunity is up.

¹⁹ Tozzi, Lisa. "Obama Criticizes A.I.G. Bonuses, Calls for Greater Regulation." Weblog post. [The Caucus: The Politics and Government Blog of The Times](#). 18 Mar. 2009. 20 May 2009

²⁰ Blinder, Alan S. "The Case for a Newer Deal." [The New York Times](#) 4 May 2009

²¹ Blinder, Alan S. "The Case for a Newer Deal." [The New York Times](#) 4 May 2009

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