The New York Times

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March 1, 2010

OP-ED COLUMNIST

Financial Reform Endgame

By PAUL KRUGMAN

So here's the situation. We've been through the second-worst financial crisis in the history of the world, and we've barely begun to recover: 29 million Americans either can't find jobs or can't find full-time work. Yet all momentum for serious banking reform has been lost. The question now seems to be whether we'll get a watered-down bill or no bill at all. And I hate to say this, but the second option is starting to look preferable.

The problem, not too surprisingly, lies in the Senate, and mainly, though not entirely, with Republicans. The House has already passed a fairly strong reform bill, more or less along the lines proposed by the Obama administration, and the Senate could probably do the same if it operated on the principle of majority rule. But it doesn't — and when you combine near-universal Republican opposition to serious reform with the wavering of some Democrats, prospects look bleak.

How did we get to this point? And should reform advocates accept the compromises that might yet produce some kind of bill?

Many opponents of the House version of banking reform present their position as one of principle. House Republicans, offering their alternative proposal, claimed that they would end banking excesses by introducing "market discipline" — basically, by promising not to rescue banks in the future.

But that's a fantasy. For one thing, governments always, when push comes to shove, end up rescuing key financial institutions in a crisis. And more broadly, relying on the magic of the market to keep banks safe has always been a path to disaster. Even Adam Smith knew that: he may have been the father of free-market economics, but he argued that bank regulation was as necessary as fire codes on urban buildings, and called for a ban on high-risk, high-interest lending, the 18th-century version of subprime. And the lesson has been confirmed again and again, from the Panic of 1873 to Iceland today.

I suspect that even Republicans, in their hearts, understand the need for real reform. But their strategy of opposing anything the Obama administration proposes, coupled with the lure of financial-industry dollars — back in December top Republican leaders huddled with bank lobbyists to coordinate their campaigns against reform — has trumped all other considerations.

That said, some Republicans might, just possibly, be persuaded to sign on to a much-weakened version of reform — in particular, one that eliminates a key plank of the Obama administration's proposals, the creation of a strong, independent agency protecting consumers. Should Democrats accept such a watered-down reform?

I say no.

There are times when even a highly imperfect reform is much better than nothing; this is very much the case for health care. But financial reform is different. An imperfect health care bill can be revised in the light of experience, and if Democrats pass the current plan there will be steady pressure to make it better. A weak financial reform, by contrast, wouldn't be tested until the next big crisis. All it would do is create a false sense of security and a fig leaf for politicians opposed to any serious action — then fail in the clinch.

Better, then, to take a stand, and put the enemies of reform on the spot. And by all means let's highlight the dispute over a proposed Consumer Financial Protection Agency.

There's no question that consumers need much better protection. The late Edward Gramlich — a Federal Reserve official who tried in vain to get Alan Greenspan to act against predatory lending — summarized the case perfectly back in 2007: "Why are the most risky loan products sold to the least sophisticated borrowers? The question answers itself — the least sophisticated borrowers are probably duped into taking these products."

Is it important that this protection be provided by an independent agency? It must be, or lobbyists wouldn't be campaigning so hard to prevent that agency's creation.

And it's not hard to see why. Some have argued that the job of protecting consumers can and should be done either by the Fed or — as in one compromise that at this point seems unlikely — by a unit within the Treasury Department. But remember, not that long ago Mr. Greenspan was Fed chairman and John Snow was Treasury secretary. Case closed. The only way consumers will be protected under future antiregulation administrations — and believe me, given the power of the financial lobby, there will be such administrations — is if there's an agency whose whole reason for being is to police bank abuses.

In summary, then, it's time to draw a line in the sand. No reform, coupled with a campaign to name and shame the people responsible, is better than a cosmetic reform that just covers up failure to act.

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