



REGULATING KING KONG
Sunday, September 20, 2009

Every week CUIP's president Jacqueline Salit and strategist/philosopher Fred Newman watch the political talk shows and discuss them. Here are excerpts from their dialogues compiled on Sunday, September 20, 2009 after watching selections from "The NewsHour with Jim Lehrer," "This Week with George Stephanopoulos," and "The Charlie Rose Show."

Salit: This week marks the one year anniversary of the collapse of the Wall Street giant Lehman Brothers. There are a lot of interests trying to sort out and spin what happened.

Newman: I think the policy down in Washington is "keep the people confused."

Salit: Very much so. Let's agree, in having our discussion, that we're not economists, we're not bankers, we're not reporters who cover the financial sector, or anything like that. That said, the one-year anniversary of the failure of Lehman has become an official occasion to discuss the state of capitalism. The president went to Wall Street and proposed three things. He said that we need a new federal agency to which the banking and financial sectors will be accountable. We need legislative authority to intervene. And, we need a new regulatory matrix to make sure that the crisis of a year ago doesn't repeat itself. So, let me run some of the current analyses by you and see how you react to them. First, there's discussion about how Bernanke, Geithner, Paulson, and Summers handled stabilizing the banking system. There was discussion of the institutions that are "too big to fail." It is said that they deserve praise for what they've done but, these commentators observe, we should also note that the guys who brought us back from the brink are the same guys who brought us to the brink.

Newman: Yes.

Salit: How do you react to that observation?

Newman: We've only got a limited number of guys handling things at this level, so how could it be otherwise? Only a limited number of guys have access to playing in this game.

Salit: Right.

Newman: So, it's virtually true by definition that the guys who got you out of it are the guys who got you into it. That's who plays the game. But here's my question. Does it make any sense to speak of simultaneously creating a very imposing regulatory system while at the same time adhering to a doctrine of "too big to fail?" How can you possibly put those two together?

Salit: That's interesting because my first thought is that they absolutely go together.

Newman: How so?

Salit: Because that's why you have a regulatory system. If the argument is that there are certain institutions that are too big to fail, you need a regulatory matrix that supports them doing what they need to do, but keeps them on this side of the brink.

Newman: Alright. But the motivation to become "too big to fail" is to make it so big that you can be assured that your bank, or brokerage, or insurance company won't fail.

Salit: Yes, there's an incentive there, surely.

Newman: If you're "too big," you can't fail, on that doctrine. They won't let you fail.

Salit: Because "too big to fail" means...

Newman: ...the government will bail you out. So, if you're too big to fail, then it seems to me that it's reasonable for the people who are playing that game to infer that they should get as big as possible.

Salit: The bigger you are, the more protected you are if you get into trouble.

Newman: You can't get into trouble, is the point. I'm saying that if certain institutions are simply "too big to fail," then what does it mean to have regulations?

Salit: Maybe that's connected to another theme in the discussions about Lehman. Pretty much everybody said that nothing much has changed in the year since the collapse.

Newman: They are connected. I'm raising what could have changed. I take there to be contradictory and competing basic principles. The greed of capitalism ultimately creates a kind of systemic contradiction and chaos which makes it impossible for capitalism to go on. I get that from Marx. It's an insight that is validated in the course of events today. That's what he identified, as I understand it, as capitalism containing the seeds of its own destruction. They're not like real seeds that you'd buy at the...

Salit: ...farmer's market.

Newman: ...Right. These are the seeds of its destruction.

Salit: So Keynes and Keynesianism is presumably the resolution of Marx's well-articulated contradiction.

Newman: But the same people that said that Keynes had the resolution of that problem are saying that the problem hasn't really been resolved.

Salit: True.

Newman: As in, “Everything is the same now as it was a year ago.”

Salit: Yes. So, we watched a Lehrer show interview with Nassim Taleb, who is a chaos theory guy and an economist. He was emphatic that what you have here is a situation where private debt is being converted to public debt, while the leverage levels are the same and the risk factor is worse than it was, ergo that nothing has changed. He is among those who issued warnings about pending collapse before it came to pass and he continues to make those same warnings. But there is another camp saying that what got established off of this whole episode is that government intervention is both necessary and effective. I’m saying that in response to your comment that Keynesianism doesn’t change the underlying problem.

Newman: But that’s what they’re saying.

Salit: Yes. The postmodern Keynesians – like Robert Reich or the economist from Princeton, Alan Blinder – are saying we should do whatever bailouts are needed, even if it creates problems – as in insurmountable debt – that we will have to deal with at some point.

Newman: This is the standard story – 1929 crash, deep Depression, endless regulations put in place. But now, in the last year or two or three or whatever, it turns out the regulations did nothing to halt what took place last September.

Salit: Of course, you’re right about that. And some argue that’s why we need a new regulatory matrix. That’s, in effect, what Obama is saying. The regulatory system failed to check the kinds of things – the greedy things – that are now going on in international finance capital.

Newman: Right.

Salit: And so, in effect, we need to update Keynes. The principle of government intervention remains sound. Unfettered markets are too unstable, volatile, and destructive. We need more suitable, more aggressive, forms of regulation.

Newman: You can say that. Then the conversation can continue by my saying: why is there reason to believe that a new kind of regulation will be more successful than the last set of regulations, which are constantly being circumvented, including by creating financial products that are virtually impossible to regulate? Evidence indicates that they will be successful in circumventing new regulations, since they already have been. If they hadn’t, we wouldn’t be talking about a collapse at all.

Salit: Correct.

Newman: So what reason is there to believe that such regulations will succeed, particularly when the process of regulating begins, so to speak with a model of having certain institutions that are “too big to fail”? If you operate off of that premise – which both Bush’s and Obama’s teams did – then it means that if you reach a certain level of “bigness,” you can do what you like because you have a guarantee that you won’t fail. How do those two go together?

Salit: That’s very tricky. I would say the best argument for how they go together is this: What Keynesianism means at this point in time is that the government, on behalf of the public interest, has to regulate or modulate the rate of growth and where growth occurs. In other words, that you have to introduce – and this is an updated version of an old debate – a level of economic planning, i.e., a form of socialism, not at the distribution level (because that’s not what they’re talking about), but at the level of wealth creation. One of the things that went wrong in this last cycle is that there were certain financial products (the subprime mortgage derivatives, etc.) that were so overleveraged, that they could unravel and, worse still, unravel the institutions that created them. So, some of the regulatory initiative will go in the direction of limiting the leverage, limiting the distance between debt and collateral, between paper economic growth and real economic growth. That’s the best answer to the question that you’re raising of how these things go together. The profit motive, the greed of American capitalism is a violently moving surge towards wealth creation and private ownership. Intervention and serious regulation presumably looks more and more like saying what kinds of wealth you can create and what kinds of wealth you can’t create. Or what’s going to be considered wealth and what’s not going to be considered wealth. It’s that genre of regulation. It can’t just be that you have to file a quarterly report with the SEC. It’s got to be more interventionist than that. Then you’re into the fight of how much Wall Street is going to accept at the regulatory level and how much of a political fight there’s going to be about that. I presume it’s going to be huge.

Newman: They don’t ask the rest of us how much leverage we’re going to accept.

Salit: No.

Newman: So that’s already a profound concession to Wall Street.

Salit: I would say so.

Newman: And that’s already several steps down the road to “too big to fail.” It was Wall Street that was too big to fail. It wasn’t Main Street that was too big to fail. The Fed didn’t put a limit on the number of people the banks – or any industry – could lay off. That’s not even being considered or discussed, meaning that bailouts would be conditional on maintaining current levels of employment, just as one example.

Salit: Systems that have been more interventionist and more socialistic, like in Western Europe, do have provisions for that. They have formulas that private companies have to follow relative to when profits are down, how certain workforce levels have to be

maintained. There are protections for the workers that are built into the system. Those don't exist here. There's nothing like that at all. We have unemployment insurance.

Newman: That's the opposite of what you're talking about.

Salit: The exact opposite.

Newman: That's insurance for those who are unemployed, not insurance against becoming unemployed.

Salit: Yes. Back to Nassim Taleb. He's one of the people saying that nothing has changed – other than that the leverage equations are more risky today than they were when all of this started. Private debt converted to public debt. He said that the policy that's being pursued by the Obama administration, which is this kind of post-Keynesian Keynesianism, is risky and immoral. Risky because of its potential for further and more dramatic collapse.

Newman: Risky because it won't work, in the long run.

Salit: And immoral because it is placing an entire system, on which people's lives are completely dependent, at risk.

Newman: It's turning it over to our children because that's who's going to be around in the long run.

Salit: Yes, and they'll inherit this risk-laden system that ultimately will collapse. Do you hear Taleb saying similar things as Marx? Do you hear him saying what we're seeing here are “the seeds of its own destruction?”

Newman: At a minimum, I hear him saying there's got to be a complete structural overhaul in order to prevent that. The whole system must be changed. I hear him, if not saying that, at least implying that. Look, the Keynesian notion of simply regulating a system that devours – and based on Marx' and Rosa Luxemburg's insights, must devour – everything around itself, including ultimately itself, well, how do you regulate that kind of monster? Why will that monster be regulated by anything? The monster that you've created has now come back to consume you. It's like the dilemma of child-raising. If you raise a child who turns out to be a “monster” and then you say to that child, *We're going to put you under a set of regulations which are going to dictate what you can and can't do.* But the child is big enough and bully enough to say, *I'll do whatever the hell I want. How are you going to stop me?* The person who created this monster child says *Listen. There are some things that you can't do. There are some absolute No's.* And the response is *I'm bigger and I'm better at this game that you've constructed than you are. I'm your child. You made me. And you're going to keep feeding me, no matter what I do.*

Salit: “Too big to fail” might mean “Too big to regulate.”

Newman: You see, regulation of the kind that's under discussion, is empty. All they're really saying is, after the fact we'll figure out what we should have done or could have done. But how does that help you to regulate? It doesn't. And the monster says, *Your regulations are just my next meal.* That's true almost by definition *Because*, says the monster to the regulators, *you need me or else the system you want to keep intact will fall apart. So, I'll just keep doing this because you're always going to save me.* If I understand anything resembling rational logic and if I understand what the economists and analysts are saying, it's that the system both has been saved and hasn't been saved. So, where are we? That's roughly where we were when this whole thing started.

Salit: How big a throw down do you think Obama is ready to have with Wall Street?

Newman: What's he throwing down? You can call it a throw down, but if you look more carefully, you might discover that it's just a wink and a nod.

Salit: I presume he's going to put some kinds of regulatory proposals on the table in Congress that different elements on Wall Street aren't going to like, for one reason or another. And there'll be a fight about that and some kind of compromise will get worked out. Congress will get a modicum more control over...

Newman: ...over fundamentally uncontrollable behavior. Look, the gorilla cage at the Central Park zoo wouldn't contain King Kong.

Salit: You bet. You'd have to build a superhuman cage to control him.

Newman: And the system that they're looking to regulate not only permits uncontrollable behavior...

Salit: ...it is based on that.

Newman: Yes. It encourages that. It works off of that.

Salit: The CEOs, the financial journalists, etc. will pretty much acknowledge that the business of international finance capitalism has become, in so many ways, incomprehensible. The former CEO of Paine Webber, Donald Marron, who now runs a hedge fund, described a situation where the major banks didn't even understand the nature of their own businesses. There were divisions and products that were so offline as to be immeasurable.

Newman: To analyze what you're saying, I'd have to analyze your tone of voice. You said, 'They didn't even understand.' You say something like that in the tone of voice you're saying it and the message I get from what you're saying is *Could you believe it? Even they didn't know what was going on.* Knowing what's going on is not automatically a benefit. As a matter of fact, we live more and more in a "need to know" world.

Salit: You need to know the things that you need to know...

Newman: ...and you don't need to know what you don't need to know...

Salit: ...to get through the next day.

Newman: The best Wall Street players are smart enough to have realized this. They're well into playing this new game. There's so much expertise, but a narrow expertise. Different people know this and different people know that. And they've learned well to adapt to and make good use of a system which includes that epistemic reality, if you will, to further advance their bottom line.

Salit: They certainly have.

Newman: In the old days – what we now call “the day” – we would have said *It's the best of rational thinkers trying to solve the problems of a fundamentally irrational system*. Well, today the better you are at being rational, the less capable you are of solving the problems of irrationality. What's next? Beats us.

Salit: Thanks, Fred.