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Another Toothless Wall Street Probe

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The Financial Crisis Inquiry Commission, meeting anew this weekend to finger culprits in the global credit bust, is well-meaning, full of smart people—and utterly useless.

Evan Vucci / AP Photo

Believe it or not, despite polarization and paralysis in Washington, there are bipartisan commissions working away, earnestly and methodically, on problems of critical national importance. We should be grateful for these exceptions, but not too grateful, since sometimes they are of little use.

Case in point: the Financial Crisis Inquiry Commission, established last year to examine the causes of the global credit bust and to report its findings to President Obama, the Congress and the American public by this December. The FCIC just wrapped up its second set of hearings on Saturday afternoon.

> The FCIC may have been an idea whose time has come and gone, even as it's just getting started.

To be sure, the commission is staffed with some exceptional talent. It is chaired by former California State Treasurer Phil Angelides, a Democrat, with Bill Thomas, former Republican chairman of the House Ways and Means Committee, as vice chairman, and it includes heavyweights such as Brooksley Born, former head of the Commodities Futures Trading Commission in the Clinton administration, and Douglas Holtz-Eakin, former head of the Congressional Budget Office. Last month, the FCIC heard from the heads of America's largest banks—Goldman's Lloyd Blankfein and J.P. Morgan Chase's Jamie Dimon among them. Over the past two days, a number of leading academics testified on an exceptionally broad range of financial and economic topics, from highly indebted banks to the state of the public's financial literacy. Over the next 10 months, the commission will have amassed a considerable amount of information on every aspect of the global credit debacle.

To a great extent, though, this same ground has been plowed by more than a year of congressional hearings. For those who have been following the debates over financial reform, it is hard to believe that there will be much that is big and new in the commission's conclusions. It would be one thing if the commission was going to produce the definitive analysis of big financial crises and what we have learned from them, a tome that could be studied for years to come. But this would be impossible to do in the one year the group has been given to do its work, especially since the crisis isn't over yet. After all, normal lending has not returned, leading as a result to weak growth, high unemployment, and a shaky housing market. It would be like examining the cracks of an airliner while it is still in flight. If we wanted instant analysis and replay, we can turn to countless books, many very well done, ranging from *Too Big to Fail* by Andrew Ross Sorkin or *Too Big to Save* by Robert Pozen. Or we could delve into thousands of background papers amassed by Congress or international organizations such as the International Monetary Fund. In the end, though, I believe we can already anticipate the big themes that will eventually underlie the commission's report.

First, every major financial crisis is rooted in similar problems—lending institutions that were much too leveraged (Lehman and Bear Stearns, for example, had debt to equity rations well over 30 percent), credit standards that were far too lax, and a collective delusion that enveloped bankers, regulators, politicians, and ordinary citizens that current circumstances uniquely favored more credit extension because “this time it’s different.”

Second, each of the successive crises—the Latin American debt crisis of the 1980s, the Asian financial crisis of the 1990s, the bursting of the dot-com bubble at the turn of the century, and now the global credit contraction—encompassed a greater range of financial assets (equities, bonds, commodities, real estate, derivatives, etc.) and has had more extensive global fallout. No mystery here: The world and markets are becoming more interconnected at warp speed.

Third, there is never just one group at fault. For the 2007 crash, for example, for starters we can blame greedy and hypercompetitive bankers, negligent regulators, conflicted credit-rating agencies, and proponents of extreme deregulation in the Clinton and Bush administrations and on Capitol Hill.

And fourth, the initial spark always comes from an unexpected source, such as a sudden devaluation of the currency of Thailand, the baht, in 1996, or, in 2007, tensions in the obscure subprime mortgage market.

Even if the commission’s analysis broke vital new ground, the FCIC is prohibited by mandate from recommending new policies. It wouldn’t have made much difference, anyway. At the end of last year, the House of Representatives passed extensive banking legislation. It is possible that the Senate Banking Committee, which is having intense discussions this weekend, will report out a bipartisan bill next week or soon after, and it even appears likely—say 70 percent likely, in my view—that Congress will pass a bill that President Obama will sign in the next few months.

That legislation will contain many important provisions, including: higher levels of bank reserves; limits on excessive financial leverage; means of closing down institutions like Lehman Brothers or AIG without a debilitating global fallout; a mechanism for better oversight of risks of the entire financial system, as opposed to just individual banks; and enhanced protection for consumers. Some critics will say that there are few deep-seated structural changes such as Paul Volcker’s recommendations that deposit-taking banks should be prohibited from certain risky investments, and that banks should not be able to grow beyond a specific size. I believe that oversight of derivatives will have too many gaps and also that whatever Congress and the administration does will have to be adjusted to upcoming global rules, given the global nature of the markets. Still, Congress has made a credible effort, and the commission will have had zero impact on it.

Finally, in the year that the commission will be operating, and, for that matter, the year Congress may pass landmark financial legislation, underlying conditions will likely have dramatically changed from what they were when the bubble burst. The locus of financial markets will increasingly be in Asia, where growth has been more than three times as fast as in the U.S. or Europe, where more wealth will be generated in the next decade than in the U.S., Europe, and Japan combined, and where investment opportunities are off the charts (trillions in infrastructure, for example). Closer to home, massive private-sector investments in entrepreneurial job- creating ventures will soon become a national preoccupation, replacing subsidies, which we cannot afford and which will not have lasting impact anyway. Soon, therefore, we’ll be worried less about new regulations than about not handicapping our banks with too many restrictions.

There is a strong risk, too, that the commission’s work will be overtaken by yet another crisis. Surveying the global landscape now, there is no shortage of possibilities. Governments around the world could collectively reverse course and end their stimulus and other direct support programs too quickly, and inadvertently create a second global recession. The unfolding drama is Greece could cause exceptional strains throughout the 16 countries that use the euro—strains that will be communicated to global finance and trade everywhere. The extraordinary fiscal deficits and sharply escalating national debt in the U.S. could lead foreign investors to lose confidence in the dollar and cause the Fed to raise interest rates to sky-high levels to keep attracting foreign money, a move that would choke off what is already anemic U.S. growth. China, the world’s economic engine now, could begin a significant growth slowdown to ward off serious inflation, unleashing a downward global economic spiral by forcing a cutback of exports from other nations.

Bottom line: The FCIC may have been an idea whose time has come and gone, even as it’s just getting started.

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