A Wasted Crisis?

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and addictive to special interests the de-

grated image is just a by-product of the po-

titical circumstances of our time.

The financial crisis, the recession, and the

anemic recovery have done nothing to

dispel popular distrust. When it bailed out

some of the nation's biggest financial institu-

tions after the collapse of Lehman Brothers

in September 2008, the government may

have staved off a total economic collapse,

but it confirmed for many Americans that

moneyed interests get help that ordinary

citizens do not receive. Beyond the imme-

diate emergency, the financial crisis also

set up a critical test of governing capacity:

could Congress and the incoming Obama

administration take advantage of the crisis,

defy cynical expectations, and adopt effec-

tive legislation to restore financial stability

and prevent another meltdown? Both the

new president and congressional leaders

pledged to make that goal a high priority

at a time when Democrats would have sub-

stantial majorities on Capitol Hill and public

opinion surveys showed broad support for

reining in Wall Street. But financial reform

posed a difficult test for several reasons—the

political power of the industry, the com-

plexity of the issues, and the complexity of

leading Democrats in the policies that

helped to bring about the crisis.

Even among special interests, finance is

special. According to the Center for Re-

 sponsive Politics, which tracks political

donations, "the financial sector is far and

away the largest source of campaign con-

tributions to federal candidates and parties.

Thanks in part to federal policy, finance has

become the dominant sector of the econo-

my, increasing its share of total domestic

profits from 15 percent in the early 1980s

to 41 percent in the early 2000s. The finan-
ciation of the economy promotes the fi-

nancialization of politics, as money finds its

way to power. The 2008 crisis made some

new regulations likely, but the industry's

leaders were dead set against any changes

they saw as threatening their profits, and

they were prepared to spend heavily on

lobbying and political contributions to en-
sure that wouldn't happen.

The complexity of financial policy also

encourages congressional deference to Wall

Street. The ultimate basis of finance's power

is structural: if governments adopt policies

that genuinely threaten financial markets,
capital will migrate elsewhere, credit will

tighten, and economic growth will suffer.

But the more complicated the markets be-

come, the more difficult it is to know where

the danger point lies. Complexity amplifies

the industry's influence in discussions about

alternatives, because its CEOs and lobbyists

can make inflated claims of perils reper-
cussions from change that legislators do

not know enough to discount. Technical

complexity also limits countervailing public

pressure to resist Wall Street's demands.

Although Democrats saw the 2008 crisis

as requiring new rules, the party's leaders

had championed financial deregulation
during the 1990s and were eagerly and suc-

cessfully competing with Republicans for

the industry's campaign contributions. In

1999, Bill Clinton and his economic advi-

ers, as well as top Democrats in Congress,

had supported the legislation repealing

Glass-Steagall, the Depression-era law se-
gregating commercial banks (and their federa-

tly insured deposits) from investment bank-
ing. "Removal of barriers to competition"/

Clinton had declared on signing the repeal,

"will enhance the stability of our financial

services system." Removing those barriers

did exactly the opposite. Clinton had also

signed legislation in 2000 barring any regu-
lation of financial derivatives, which was

the market that would be at the center of

the crisis eight years later. In 1996, Senator

Chris Dodd of Connecticut had even played

a leading role in overcoming Clinton's veto

of legislation that fulfilled one item in the

Republicans' Contract with America by

making it more difficult to prove private

securities fraud. A longtime booster of Wall

Street who became chair of the Senate

Banking Committee in 2007, Dodd would

have a critical role in financial reform after

the crisis. And Barack Obama brought back

to the top ranks of economic policy-making

the very people who had admired Clinton to

support financial deregulation.

While other recent books have dissected

the Obama administration's response
to the economic crisis, three new books focus on Congress and present the battle over financial reform as a case study with general lessons about American politics. The books treat many of the same events and deal with the same basic problem of democracy versus the power of finance, but they approach the story from entirely different angles. Robert Kaiser's *Act of Congress* is a step-by-step, journalistic narrative of the legislative process from the eruption of the financial crisis in September 2008 through the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010. In Kaiser's telling, Congress overcame special-interest pressures and partisan obstruction, worked through complex issues, and enacted substantial and intelligent legislation. In stark contrast, Jeff Connaughton's *The Payoff* is a burn-all bridges memoir of a longtime lobbyist who became a top aide to a liberal Democratic senator and says that Dodd-Frank was shot through with holes as a result of special-interest pressures and the connivance of both Dodd and the administration. And in the most weighty and analytical of the books, *Political Bubbles*, the political scientists Nolan McCarty, Keith T. Poole, and Howard Rosenthal argue that 2008 was a "wasted crisis" because American democracy failed not only in the run-up to the bailouts, but also in the aftermath. Dodd-Frank, they say, exemplifies a long historical pattern (except for the New Deal) of weak and often counterproductive governmental responses to breakdowns in the financial system.

TO THOSE WHO BELIEVE IN THE honor of the legislative craft, Kaiser's book will come as welcome relief from the steady stream of television and movie portrayals of Congress as a snake pit of vanity and corruption. A veteran Washington Post reporter, Kaiser enjoyed exceptional access to the two central figures in the real-life drama of financial reform, Barney Frank and Chris Dodd, as well as to their aides and influential lobbyists. The result is an inside-the-Capitol narrative that largely reflects the viewpoint of its protagonists. As the author of an earlier book on lobbying, Kaiser is under no illusions about the purity of congressional politics: Congress, he says, is a "broken" institution. But the gist of his book is that, despite everything that is wrong with it, Congress succeeded in passing a landmark reform, thanks mainly to two legislators who put governing ahead of politics in what was, for each of them, the culminating achievement of a long political career.

Different though they are in skills and personality, Frank and Dodd shared, according to Kaiser, the practical wisdom required to get things done. Frank, who became chair of the Financial Services Committee in 2007 after serving in the House for twenty-six years, emerges as brilliant, conscientious, and deft in dealing with his fellow representatives. Known publicly for his barbed wit, he enjoyed wide respect among his colleagues for his mastery of the technical details of financial regulation. ("I've learned an enormous amount of things I never wanted to know," he tells Kaiser.) If there is one surprise in Kaiser's portrayal, it is that Frank was entirely consumed with the "inside" game. "Mobilizing public opposition against rapacious bankers and lax regulators was not a priority for him," Kaiser writes. "He had low expectations for the role of public opinion, especially on complex issues." Although attentive to the concerns of liberal Democrats, Frank had no interest in tilting at windmills; he accepted the framework of the bill developed by the Obama administration, adjusting it in particulars, often to keep his party diatribe by the ranking Republican, Richard Shelby of Alabama, and then paired up Republican committee members with Democrats to work on specific issues of concern to them. The unsavory aspects of Dodd's career get only passing mention—the senator benefited from financial favors that when exposed in the media led him to announce that he wouldn't run for reelection; but as Kaiser tells it, Dodd's retirement happily served the public good by enabling him to focus his energies on financial reform.

If all you want to know is how Congress passed the bill it passed, Kaiser's book has the story. In the House, for example, where Democrats had a big majority, Frank's problem was not to win over Republicans but to maintain significant support from his own party's centrist Blue Dogs. A key step in that process, according to Kaiser, was a deal that Frank struck in private with the Independent Community Bankers of America, the trade group representing small "hometown" banks that have influence in every congressional district. Frank agreed to two concessions: a limit on the supervisory authority of the new agency that the law would establish to protect consumers, and a change in the formula for assessments paid to the Federal Deposit Insurance Corporation, which would shift more than $1 billion in annual fees from the community banks to the big banks. Wall Street would not like it, but by peeling off the hometown banks, Frank reduced local pressure on the Blue Dogs and other representatives to oppose the bill.

Stories such as these are instructive, up to a point; they tell us about overt conflicts in the legislative process. But Kaiser's book has little to say about the law's general framework or about ideas for reform that did not enter into the main congressional negotiations. Financial reform itself isn't
to the economic crisis, three new books represent the battle over financial reform as a case study with general lessons about American politics. Each book explores a different angle on the making of the financial crisis in September 2008 through the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010. In Kaelin’s telling, Congress overcame special-interest pressures and partisan obstruction, worked through complex issues, and enacted substantial and intelligent legislation. In contrast, Jeff. K. Toobin’s book is a bridge memoir of a lifetime lobbyist who became a top aide to a liberal Democratic senator and says that Dodd-Frank was shot through with holes as a result of special-interest pressures and the compromise of both sides, senators, and the Administration. And in the most weighty and analytical of the books, Political Bubbles, the political scientists Keith T. Poole and Howard Rosenthal argue that 2008 was a “wasted crisis” because American democracy failed most notably in the grasp of the New Deal of weak and often counterproductive governmental responses to breakdowns in the financial system.

To those who believe in the honor of the legislative craft, Kaelin’s book will come as welcome relief from the steady streams of television and movie portrayals of Congress as a snail pit of vanity and corruption. A veteran Washington Post reporter, Kaelin is a lifelong intellectual access to the two central figures in the real-life drama of financial reform, Barney Frank and Chris Dodd, as well as to their aides and influential lobby- tyits. The book is an inside-the-Capitol narrative that largely reflects the view of its protagonist. As the author of an earlier book on lobbying, Kaelin is under no illusions about the purity of congressional politics. In a “task force” institution. But the gist of his book is this, that despite everything that is wrong with it, united. Irrelevantly practical, he made sure the bill would pass.

Dodd’s personal attributes were every bit as important, Kaelin writes. Not brilliant as Frank but “bright enough,” Dodd was popular with both Democrats and Republicans. In dealing with them, looking for ways to address the “substantive concerns of his colleagues,” Kaelin says. In a “tactful” manner. Kaelin recounts that at the Banking Committee’s first meeting on the bill, Dodd ignored a proposal by the ranking Republican, Richard Shelby of Alabama, and then paired up Republicans committee members with Democrats to work on specific issues of concern to them. The unsavory aspects of Dodd’s career got only passing mention, Kaelin says. “In the Frank-Dodd friction that favors the Washington in the media led him to in- dicate that he wouldn’t run for reelection, but at Kaelin says it. Dodd’s retirement staff served the public good by enabling him to focus his energies on financial reform. If you all want to know how Congress passed the bill, read Kaelin’s book for the story. In the House, for example, where Democrats had a big majority, Frank’s problem was to get the way their way in the House was to maintain significant support from his own party’s leadership. A key step in that process, according to Kaelin, was a deal that Frank struck in private with the Independent Community Bankers of America, the trade group representing small “hometown” banks that have influence in every congressional district. Frank agreed to two concessions: a limit on the supervisory authority of the new agency that the law makes less risk-taking. Frank was keen on a change in the formula for assessments paid to the Federal Deposit Insurance Corp. (FDIC) and a provision that would limit any increase in the FDIC’s insurance fees from Wall Street.

A new book that describes the “Machiavellian” road to making concessions to Republicans who were not going to vote for the bill, while ignoring his Democratic colleagues. “Dodd and the Treasury Department wanted a spiky bill,” Connally writes, “and the Republican leaders were willing to work with Dodd on the legislative side.” When the Treasury Department was out of committee, Kaufman delivered what Connally describes as a “withering critique.” The bill relied too much on executive discretion, prepared “only a roughshod set of regulatory powers that already exist,” and had limited the regulatory powers that were already in place for the financial crisis. Connally’s response was to leave a voice mail message: “Stop saying bad things about my bill.” Kaufman’s alternative, as Connally describes, was to establish clear statutory lines placing “strict limits on the size, leverage, and trading activities of the behemoth banks.” An amendment to reduce the likelihood that a few too-big-to-fail banks could again threaten to bring down the government, the government no choice except to save them, like Kaiser, Connally provides a view of the bill that tracks him inside-the-white house at the bill’s time— but he is hardly critical not only of Dodd’s but also of the Obama Administration. Kaiser was “amused by the government’s failure to undertake criminal prosecutions of financial fraud. The message of his book is that Democratic leaders in Congress as well as the administration were so deeply compromised by their ties to Wall Street that they would act effectively on the people’s behalf.

Barney Frank stuck to the “inside game” as Obama, he made no effort to mobilize public opinion against Wall Street.

Goethe’s Nightongs

Over the hills
Comes the quiet.
Across the treetops
Nothing.
Not a sound—

Birds in the woods are quiet.

Ah, what sweet quiet!

Will be quiet, too.

Translated by David Lehman

Barney Frank was put to the test in the “inside game” as Obama, he made no effort to mobilize public opinion against Wall Street.
and Kaufman. "We favor a strong set of simple rules rather than regulatory discretion," they write. "The thirty-seven pages of Glass-Stegall are much to be preferred to the nearly three thousand pages of Dodd-Frank." But they take a different approach to explaining the congressional politics of financial reform. Unlike those who write about Congress from the inside and highlight individual personalities, the political scientists put their emphasis on more general forces. Their argument is that the interplay of ideology, institutions, and interests results in characteristic failures of democratic government in handling financial crises.

According to McCarty and his co-authors, the United States has exhibited a historical pattern dating back to the nineteenth century of political bubbles inflating financial bubbles. By a "political bubble," they mean "a set of policy biases that foster and amplify the market behaviors that generate financial crises.... During a financial bubble, when regulations should be strengthened, the political bubble relaxes them. When investors should hold more capital and reduce leverage, the political bubble allows the opposite." And when the financial bubble ultimately bursts, the political response is limited and slow, typically depending on a change in power. In the one (partial) exception to the rule, the Great Crash in 1929 set in motion a belated but big enough shift in power and ideology to bring about a strong, structural response. Not only did Congress pass Glass-Stegall, which established government insurance of bank deposits as well as the separation of commercial and investment banking; the federal government (and the states) also provided significant debt relief to small borrowers, including both farmers and homeowners.

But "times have indeed been different" since the New Deal, McCarty and his co-authors argue, because the "opponents of change" have "succeeded in limiting the legislative response to a crisis." That was the case after the savings-and-loan crisis in the 1980s, which resulted in the creation of a weak regulatory agency, the now-defunct Office of Thrift Supervision. That has also been true in the recent crisis, when "Washington rushed to bail out the commercial and investment banks and American International Group (AIG), but did little to relieve small debtors" and Congress passed Dodd-Frank, which "leaves ample opportunities for future bubbles."

The principal forces that have limited the government's response to the recent financial crisis are hardly mysterious. Ideologically, the crucial change has been the rise of free-market conservatism—"the belief structure," as McCarty and his co-authors describe it, "most conducive to supporting political bubbles." Institutionally, the key development has been the increased use of the filibuster in the Senate. Together, the growth in ideological polarization in Congress and the exploitation of institutional choke points have led to gridlock, blocking legislative adjustment of policies as conditions change. And in the case of finance, that failure to update policy has effectively meant deregulation, because of the creation in recent decades of new financial products not envisioned under the New Deal regulatory regime.

Finance-friendly government has also resulted from the industry's increased lobbying and political contributions in an environment where countervailing pressure from consumer groups is negligible. Even in the latest battle, the imbalance has been staggering. According to Kaiser, a consumer coalition in 2009 announced it would raise $5 million to support financial reform; in comparison, the lobbying expenditures by the finance industry in 2009 and 2010 totaled around $750 million. Wall Street political contributions, McCarty and his co-authors point out, have gone to both Democrats and Republicans, though not indiscriminately. "The more conservative wing of each party (moderate Democrats and conservative Republicans) garners substantially more contributions than the more liberal factions." The finance industry is bipartisan in the sense that it pushes both parties to the right.

In their analysis of Congress, McCarty, Poole, and Rosenthal draw on their extensive prior work on congressional voting. That work shows that regional and other influences matter much less today than in the past; votes follow ideological positions in a pattern characterized by sharply increased polarization (less bunching of representatives in the ideological center). The upshot of this analysis is that, even when Democrats are in power, the most liberal bill that Congress can pass depends on the position of what they call the "veto pivot." In the Senate, due to the filibuster, the pivot for the Democrats is the senator who is sixth from the liberal end of the ideological spectrum. When Dodd-Frank came to a vote, the pivot proved to be Scott Brown. (Democrats needed Brown's vote because one seat was vacant after Robert Byrd's death and one liberal, Russ Feingold, refused to vote for the bill.) Under these circumstances, Dodd's conciliatory stance toward the Republicans makes perfect sense, not because he was able to persuade the Republicans on his committee to vote for the bill, but because it was clear that in the end the bill would have to be acceptable to a moderate Republican pivot, no matter whom that proved to be.

The same logic applies to the efforts that Max Baucus, as chair of the Senate Finance Committee, made to conciliate Republicans on health-care reform in 2009. Many liberals were furious about the concessions that Baucus made and the time he took in those negotiations. But even though none of the Republicans voted for the bill on the Senate floor, the efforts to conciliate them proved critical in winning over the most conservative members of the Democratic caucus, Ben Nelson and Joe Lieberman, who were the pivots for the Affordable Care Act.

The analogy between Dodd-Frank and the Affordable Care Act, the two major legislative achievements of Obama's first term, works in other ways as well. Both are highly complex laws that the public has difficulty
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Dodd-Frank, which "leaves ample opportunities for future bubbles." The principal forces that have limited the present administration’s response to the financial crisis are hardly mysterious. Ideologically, the crucial change has been the rise of a new generation of financial reform advocates. The core of this group is represented by McCrary and his co-authors. They describe how the financial crisis of 2007-2008 was caused by the failure of the "securitization" model, which allowed banks to package and resell mortgage-backed securities. This model was driven by the desire to increase profits and reduce risk.

The government’s response to the crisis was largely ineffective. In the aftermath of the crisis, the government passed the Dodd-Frank Act, which included a number of reforms aimed at preventing future crises. However, the act did not go far enough in some respects, and it was criticized for being too focused on regulatory reform rather than on preventing future crises. As a result, the financial industry has continued to push the limits of regulation, and there have been several episodes of market instability since the passage of Dodd-Frank.