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The Obama Administration and the U.S. Financial Crisis

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Abstract

There has been tremendous pressure on the Obama Administration to justify the actions taken with regards to the U.S. financial crisis which has managed to eliminate, overnight, over a quarter of the middle class wealth and leave one in six adults without a job or underemployed, while generating a bailout debt that was unimaginable in scale and scope only five years ago. In response to this public pressure, in mid-June 2009, the Obama Administration issued a white paper titled "Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation" (published by the U.S. Department of Treasury) covering a wide range of areas of financial regulation that proposed a new architecture for financial supervision. Although the White Paper touches upon many of the Administration's promised responses to the crisis with regards to new financial regulations and supervisory changes, it has been criticized as being too narrow in the scope and breath needed to manage the sheer size and scale of the impact of the U.S. financial crisis. This paper focuses on ten concerns and issues of note with the Obama Administration's actions and responses to date with regards to the U.S. financial/banking crisis and its 2009 White Paper on "Financial Regulatory Reform." They are as follows: (1) No Discussion and Minimal Attempt by the Administration to Relay Their Understanding of and Global Transmission of This Financial Crisis, (2) Proposed Financial Oversight Council, (3) Increased Powers for the Federal Reserve, (4) Most Recommendations Do Not Follow the Trend Toward Supervision Consolidation, (5) Macroeconomic vs. Microeconomic Supervision, (6) Government in the Financial Markets and Industry, (7) No Significant International Standard Setting or Coordination to Date, (8) Issue of Too Big to Fail Still at Large, (9) Obama Administration's PR Debacle, and (10) Something to Show after Spending $1.4 Trillion Plus.

KEYWORDS: Obama, U.S. financial crisis

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There is little doubt that the Obama Administration is under fire from a myriad of directions and has been besieged by accusations of not delivering on major campaign promises. This has forced the new Administration to take on a defensive posture rather than an aggressive political stance typical of a new presidency barely a year old. On January 27, 2010, President Obama delivered a State of the Union address trying to emphatically defend his election promises mostly related to the middle class and the revitalization of the U.S. economy and job creation. In summary, a scorecard of his election promises runs as follows[1]:

1) ***On The Economy:***
    a. To create or save 1 million jobs with a $25 billion investment in infrastructure project : ***in progress***
    b. Reverse former-president Bush's tax cuts for the wealthy: ***in progress***
    c. Establish a credit-card bill of rights to protect consumers: ***completed***
    d. Enact a 90-day foreclosure moratorium for who are making good faith efforts to pay their mortgages: ***completed***
    e. Enact a windfall profits tax on excessive oil company profits to provide a $1,000 emergency energy rebate to American families: ***still to do***
    f. Give the Federal Reserve greater oversight over the financial institutions it has been called on to bail out: ***still to do***
2) ***On Energy And The Environment:***
    a. Ensure 10% of U.S. electricity comes from renewable sources by 2012 and 25% by 2005. Establish a low national carbon-fuel standard: ***still to do***
3) ***On Foreign Policy:***
    a. Ban torture and close the military prison at Guantanamo Bay: ***in progress***
    b. Secure all loose nuclear material in the world with four years: ***in progress***
    c. Deploy at least two additional combat brigades and $1 billion in additional non-military aid to Afghanistan: ***completed***
    d. End the war in Iraq within 16 months: ***in progress***
    e. Engage in tough, direct diplomacy with Iran without preconditions. Offer incentives if Iranian leaders abandon the country's nuclear program and support for terrorism; step up economic pressure and political isolation if they continue troubling behavior: ***in progress***

[1] The following section is taken form The Washington Post Company, 2010.

f. Make a sustained push to support Israel and achieve the goal of two states - a Jewish state in Israel and a Palestinian state: ***in progress***

4) ***Crime And Law Enforcement:***
   a. Expand hate-crime statutes: ***completed***
5) ***On Healthcare Reform:***
   a. Insure that more American's are covered, provide a range of insurance options accessible through an exchange, and end insurance company abuses: ***in progress***
6) ***On Changing The Way "Washington D.C. Work":***
   a. End the practice of writing legislation behind closed doors and close special-interest corporate loopholes: ***in progress***
   b. Ban registered lobbyists from working in the administration on areas in which they have lobbied over the previous two years and bar officials who leave the administration from lobbying the executive branch for the duration of Obama's presidency: ***completed***
   c. Convene a bipartisan group of key lawmakers to foster better executive-legislative relations and bipartisan unity on foreign policy: ***completed***
   d. Reform government spending by slashing earmarks and conducting a line-by-line review of the federal budget: ***in progress***
7) ***On Science And Technology:***
   a. Double federal spending for basic research over 10 years: ***in progress***
8) ***On Education:***
   a. Improve education by making math and science a priority, reforming "No Child Left Behind" and streamlining the financial aid process: ***in progress***
9) ***On Homeland Security:***
   a. Create secure borders: ***in progress***
10) ***On Labor:***
   a. Ensure freedom to unionize and fight for passage of the Employee Free Choice Act: ***in progress***

Among all the issues mentioned above, rightly so, there has been tremendous pressure on the Obama Administration to justify the actions taken with regards to the U.S. financial crisis which has managed to eliminate, overnight, over a quarter of the middle class wealth and leave one in six adults without a job or underemployed, while generating a bailout debt that was unimaginable in scale and scope only five years ago. In response to this public pressure, in mid-June 2009, the Obama Administration issued a white paper titled

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"Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation[2]" (published by the U.S. Department of Treasury) covering a wide range of areas of financial regulation that proposed a new architecture for financial supervision. Although the White Paper touches upon many of the Administration's promised responses to the crisis with regards to new financial regulations and supervisory changes, it has been criticized as being too narrow in the scope and breath needed to manage the sheer size and scale of the impact of the U.S. financial crisis.

According to the White Paper, the Administration's plan outlines five initiatives[3]:

1) increase oversight of systemic risk and financial regulation with the creation of a financial services oversight council;
2) boost regulation for large, interconnected financial firms;
3) set higher capital and management requirements for all financial holding companies;
4) create a new national bank supervisor and eliminate the Federal thrift charter and loopholes in the Bank Holding Company Act; and
5) require advisers to hedge funds and other private pools of capital to register with the Securities and Exchange Commission (SEC)[4].

Of the above, there were three areas of considerable controversy that the White Paper generated:

1) It proposed two new authorities: a National Bank Supervisor and a Consumer Protection Agency. "The National Bank Supervisor supervises all federally chartered banks. The new agency will combine two existing authorities: the Office of Thrift Supervision and the Office of the Comptroller of the Currency. The Consumer Financial Protection Agency will "protect consumers across the financial sector from unfair and abusive practices[5]."
2) It further proposed to establish a Financial Oversight Council (FOC) to "identify systemic risks and improve cooperation among US regulators.[6]" The FOC would include the heads of the Federal Reserve, the Federal Deposit Insurance Corporation, the US Treasury, the National Bank Supervisor, the Securities and Exchange Commission, the Commodity

[2] Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation, U.S. Department of Treasury, June 17, 2009.
[3] Ibid.
[4] Ibid.
[5] Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.
[6] Ibid.

Futures Trading Commission, the Consumer Protection Agency, and the Federal Housing Finance Agency.

3) With regards to the Federal Reserve, the White Paper proposed to increase the powers of the central bank. The Fed "would be given new responsibilities to supervise all institutions that could represent a threat to financial stability, even those that do not own banks.[7]"

The White Paper also proposes that the U.S. Securities and Exchange Commission (SEC) should enact its plans to strengthen the regulatory framework around money market funds, including[8]:

a) requiring money market funds to maintain substantial liquidity buffers;
b) reducing the maximum weighted average maturity of money market funds;
c) tightening credit concentration limits;
d) improving credit risk analyses and management of money market funds; and
e) empowering money market fund boards of directors to suspend redemptions in

This paper focuses on ten concerns and issues of note with the Obama Administration's actions and responses to date with regards the U.S. financial/banking crisis and its 2009 White Paper on "Financial Regulatory Reform."

TEN KEY CONCERNS AND ISSUES

The following are ten concerns and issues of note with the Obama Administration's actions and responses to date with regards the U.S. financial/banking crisis and its 2009 White Paper on "Financial Regulatory Reform[9]":

1. No Discussion and Minimal Attempt by the Administration to Relay Their Understanding of and Global Transmission of This Financial Crisis

The Administration made a minimal attempt to relay their understanding of this crisis and there has been no real discussion of the different nature of this financial crisis from previous crises. Moreover, there has been little discussion of the crisis and its global transmission.

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[7] Ibid.
[8] Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation, U.S. Department of Treasury, June 17, 2009.
[9] Ibid.

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Summary Characteristics of the Crisis

An informal agreement amongst the leadership in major economies and multilateral institutions, such as, the IMF, has redefined "financial crisis," which is now being called "financial stress" to create less public panic. According to the IMF, financial stress can be thought of as "an interruption to the normal functioning of financial markets"[10]. It should be noted that it is difficult to agree on a specific definition because no two episodes of financial stress are exactly the same. Also the relative importance of these phenomena may differ from one period of financial stress to another. Prior to 1995, financial crisis were regionally contagious. For example: the 1982 Latin America International Debt Crisis (regional event), the 1989 Japan (a solitary event), the 1992 EMS/ERM Crisis of the Lira and Sterling (a regional event), the 1993 EMS/ERM Crisis of the French Franc (regional event), etc.

From 1995-2006, however, a new kind of damaging global financial contagion entered the financial system but it appeared to be restricted to countries similar in economic development – to mostly emerging markets. For example, Mexico (end 1994/1995), Asia (1997), Russian and Chile (1998), Brazil (1999), Turkey (end 2000/2001), Argentina (2002), etc.

In 2007, however, we say the beginning of what was the first truest global financial crisis of the modern banking-financial era. It began in the United States and impacted virtually every type financial market in the world. It should be noted, however, that there is still some confusion surrounding the nature of this current crisis because we do not know if "regional contagion" has indeed evolved into a devastating global contagion (as we are facing the worst global economic crisis in 60 years), or was the ferocity of this carnage so vast and fast simply because the United States is the world's largest financial market?

In the previous episodes of financial crisis (1995-2006), some of the main features were structural weaknesses, supervision and regulatory laxity (lax formal structure), crony capital (government corruption), heavily portfolio "hot" capital (in underdeveloped financial markets) with a subsequent flight of capital and freefall of local currency), and a crisis of confidence of investors.

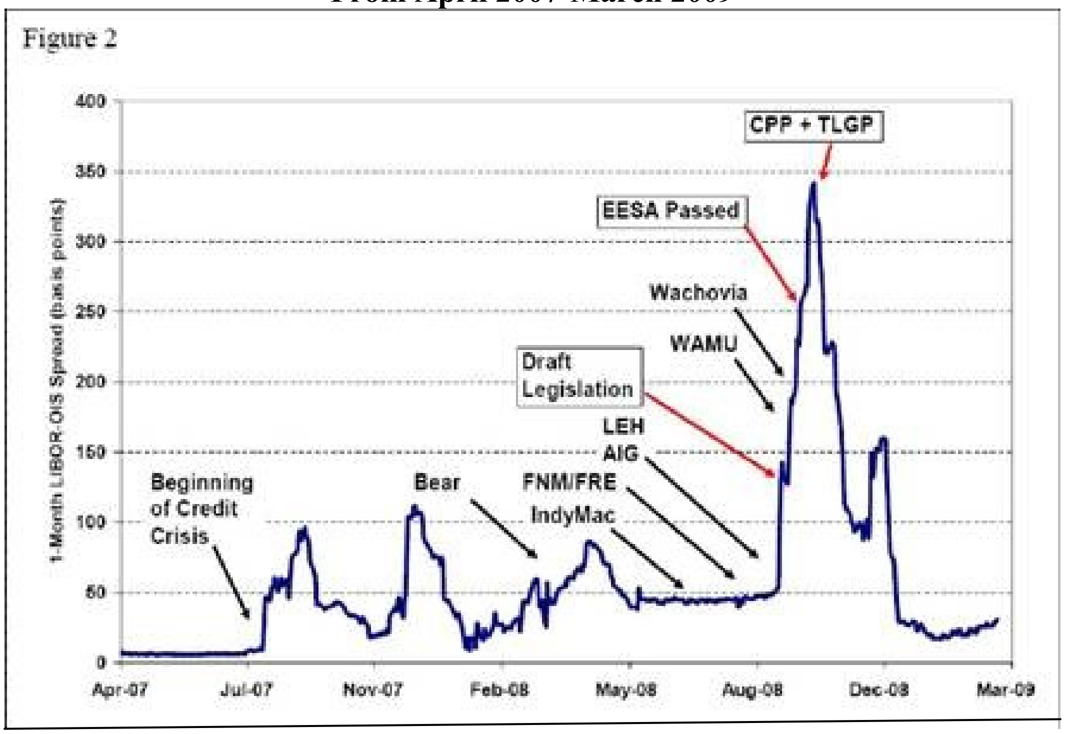
The new 2007 crisis involved some of the same features from previous crisis but also some unique new characteristics. They are as follows:

a) They were structural weaknesses/systemic loopholes (including supervision and regulatory laxity).
b) Monetary policy error was made in the world's largest economy.
c) There was no real flight of capital out of the U.S. market.

[10] IMF World Economic Outlook, April 2009.

d) The crisis involved the most important international trade and investment currency (the U.S. dollar), but there was no freefall of the dollar on the foreign exchange market.
e) The crisis of confidence was amongst banks first (instead of the marketplace) which immediately ceased lending to each other due to default [non-pmt] risk (see Figure 1) and then it spread to the rest of the marketplace.

Figure 1:
One Month LBOR-OIS Spread (Bases Points)
From April 2007-March 2009



Source: www.treas.gov/press/releases/reports/creditindicators.pdf

f) There have also been a myriad of contagion effects in the current 2007 crisis. This contagion has been spread through trade mechanisms (similar exports or exports to each other), through financial mechanisms (faster and newer technologies (computer trading), repatriation of capital, lower flows of transfer payments), and through the so-called "herd" instincts (bankers panicked). In the previously crisis the banks viewed all emerging countries as the same, but in this crisis they lost confidence in each others liquidity. The IMF's April 2009 The World Economic Outlook refined its

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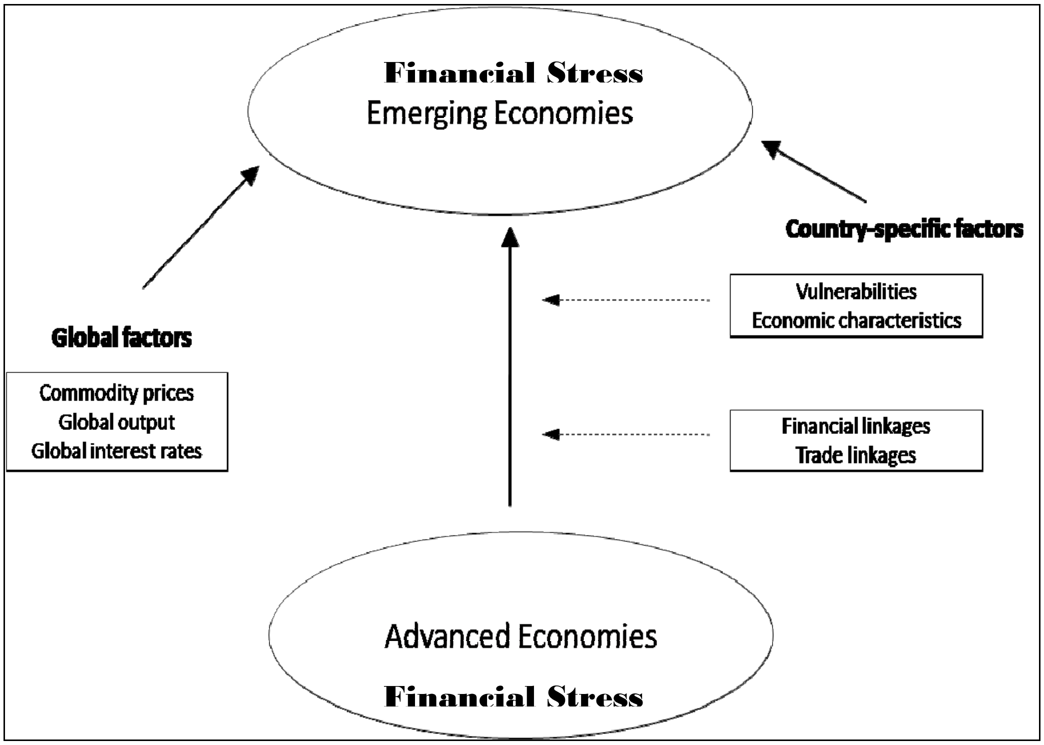
schematic map of transmission of financial shocks (stress) which can be seen in Figure 2.

Figure 2:
IMF Definition Of The Transmission Of Financial Stress as per The World Economic Outlook, April 2009



Source: The World Economic Outlook, April 2009.

g) "Bad bets" were made and in the end "…mortgage loans and investments in mortgage-backed securities could not withstand declining housing prices[11]."
h) There was excessive leveraging and it originated "…from the creative use of financial innovation that enabled banks to comply with the letter of risk-based capital rules while violating the spirit of those rules.[12]" What was astonishing is that "primary regulators" were fully aware and stamped their approval on these activities. "Techniques for creating excessive leverage included abuse of AAA ratings, creation of off-balance-sheet

[11] Kling, Arnold. "Obama Administration Proposals for Financial Regulatory Reform: A Critical Audit", FinReg21 website, July 20, 2009.
[12] Ibid.

entities, and designation of mortgages as "short-term investments" requiring no capital at all.[13]"

i) There were also many domino effects in the U.S. crisis as the interconnectivity amongst financial institutions made the misfortune of one firm cause serious problems for a myriad of others firms. For example, "…when Lehman Brothers was allowed to go bankrupt, this adversely affected a major money market fund, which in turn threatened to cause a general loss of confidence in money market funds. As another example, AIG's difficulties posed threats to its major counterparties[14]."

j) There were many domino effects in the U.S. crisis as the interconnectivity amongst financial institutions made the misfortune of one firm cause serious problems for a myriad of others firms. For example, "…when Lehman Brothers was allowed to go bankrupt, this adversely affected a major money market fund, which in turn threatened to cause a general loss of confidence in money market funds. As another example, AIG's difficulties posed threats to its major counterparties[15]."

k) We also saw 21st-century bank "runs" in this crisis which were precipitated because "…financial institutions had incentives to rush to liquidate positions ahead of one another. For example, money managers were buying commercial paper from banks' special-purpose vehicles that were holding mortgage securities. As doubts emerged about the value of the mortgage securities, it was in the interest of each money manager to curtail funding or to demand more excess collateral, even though collectively these actions may have driven the market value of the mortgage securities well below their intrinsic value.[16]"

l) The element of "too big to fail" was clearly evident in this crisis.

m) U.S. consumer's high private debt, low savings, allowed them to easily engage in risky investments in the housing boom. The Fed and other agencies were also slow in sending out a public warning about this type of high-risk consumer savings-investment behavior.

n) Governments all over the world took unprecedented steps to restore consumer confidence in this crisis -- unlike we have ever seen since World-War II. The U.S. government guarantees of savings (FDIC) increased from US$100,000 to US$250,000 in an effort to stop the entire financial system collapsing, while other countries went even further and offered savers unlimited guarantee for all their savings (see Table 1).

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[13] Ibid.
[14] Ibid.
[15] Ibid.
[16] Ibid.

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Table 1
Deposit Insurance Coverage Limits
(USD equivalents, at current exchange rates, as of mid-September and early December 2008)

Country	Mid-September 2008	Early-December 2008
Australia	0	Unlimited
Austria	20,000	Unlimited
Denmark	50,000	Unlimited
Germany	20,000	Unlimited
Hong Kong	10,000	Unlimited
Iceland	20,000	Unlimited
Ireland	20,000	Unlimited
Singapore	10,000	Unlimited
Slovak Republic	20,000	Unlimited
New Zealand	0	544,000
Norway	281,000	281,000
United States	100,000	250,000
Italy	133,00	133,000
Belgium	20,000	129,000
Greece	20,000	129,000
Luxembourg	20,000	129,000
Netherlands	50,000	129,000
Portugal	25,000	129,000
Spain	20,000	129,000
Mexico	121,000	121,000
Japan	108,000	108,000
France	90,000	90,000
Switzerland	20,000	83,000
Canada	79,000	79,000
United Kingdom	50,000	74,000
Czech Republic	30,000	64,000
Finland	30,000	64,000
Hungary	25,000	64,000
Poland	25,000	64,000
Sweden	30,000	61,000
Korea	35,000	35,000
Turkey	32,000	32,000
Russia	10,000	25,000

Source: OECD, Financial Market Trends, 2009.

Failure to Grasp the Full Character of the Crisis

Regardless of the legacy of the Bush Administration, the Obama Administration, to date, has not really seriously discussed, and some believe has failed to grasp, the full nature of the characteristics and impact of this crisis not only for the U.S. economy but the global economy. There has also been no real debate of related issues, such as, “what role has globalization played in the genesis and development of the crisis?” Other stated errors of the Administration have been gross miscalculations of the impact of the crisis during its early stages. The Administration had assumed, until Autumn 2008, that certain economies e.g. China were either immune or somewhat protected from the direct fallout of the U.S. subprime crisis and would sail through the storm with sufficient strength to pull along the entire world economy. It is abundantly clear now that that growth declined more sharply than anticipated in all regions of the world as a direct result of this crisis. Finally, the transmission of the crisis through trade was grossly underestimated even though it was clearly bound to be a major channel of transmission for East Asia, whose combined exports to North America and Europe amount to approximately 12 percent of the region’s GDP (See Table 2). A specific example is Singapore, whose international shipping port trade transportation sector, over a four month period (from October 2009 to January 2010), declined over -24% in traffic.

Table 2
Year-Over-Year Change In Total Exports For February 2009

China	-41%
Taiwan	-41%
Japan	-38%
France	-33%
Canada	-33%
Germany	-32%
Britain	-32%
Hong Kong	-27%
Mexico	-26%
Brazil	-25%
Argentina	-24%
United States	-22%
India	-22%
South Korea	-18%
Australia	-1%

Source: National Governments, via Haver Analytics, 2009.

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Table 3
Strange Global Growth Forecasts for 2009
(GDP growth forecasts, 2009)

Fastest ten

Qatar	13.8%
Malawi	8.4%
Angola	8.2%
Ethiopia	7.5%
China	7.5%
Congo-Brazzaville	7.3%
Djibouti	7.0%
Azerbaijan	6.8%
Tanzania	6.8%
Gambia	6.4%

Slowest ten

Britain	-2.0%
Singapore	-2.2%
Ireland	-2.4%
Estonia	-2.6%
Taiwan	-2.8%
Venezuela	-3.0%
Ukraine	-3.0%
Latvia	-4.0%
Zimbabwe	-4.8%
Iceland	-9.6%

Source: Economist Intelligence Unit, 2009.

At first, it was expected that the strange forecast of fast growing African countries had occurred because none of these countries had sophisticated financial markets and thus there was no financial market transmission shock. It was also thought that the trade transmission shock was going to be small given the low trade volume and value that flows in and out of these countries. Even more surprising it had been predicted that these countries would nonetheless suffer a significant decline in their welfare as the mammoth global first and second world financial crisis would reduce all major aid for hunger and healthcare. No one anticipated such a forecast.

This has, in part, occurred because of the global food crisis which has precipitated a global land and water grab. As food prices rose and the anticipated future shortage in food supply has been now been predicted to be more dire than previously forecasted, there has been an unexpected opportunity for African growth which has experienced a huge influx of foreign private capital. Approximately, 95% of Asia's cropland has already been cultivated, so that leaves mostly only African and Latin American farmland (which is usable and safe) for foreign investors. In 2008, a 100 documented land deals were done, and between 2006-2009 foreign investments (purchases of land by governments and private companies) sought or secured between 37-49 million acres of farmland in the developing world. For example, South Korea has purchased 1,300,000 hectares in Madagascar and 690,000 hectares in Sudan. Saudi Arabia now owns 1,600,000 hectares in Indonesia and 10,117 hectares in Sudan. The UAE has acquired 378,000 hectares in Sudan, 900,000 in Pakistan, and 3,000 hectares in the Philippines. Meanwhile, China owns 1,240,000 hectares in the Philippines and 700,000 hectares in Laos[17].

In addition, also unanticipated, was that many oil-rich Persian Gulf countries and other countries with large sovereign wealth funds (SWF) would use this "land grab" opportunity as a venue to diversify investments from major U.S. and European financial markets after getting badly trodden during the 2007-2009 crisis. This is also seen as a globally innovative way to create comparative advantage for food dependent countries, such as, Japan and South Korea. Moreover, it increases food security and fuel for economic growth for countries, such as, China and also allows arid countries, for example, the United Arab Emirates and Saudi Arabia, to reduce their domestic agricultural water usage and ship food back to home to their own domestic markets at cost effective prices.

2. White Paper Proposed a Financial Oversight Council

While the White Paper delivered on one of the Obama Administrations' promises by proposing the creation of a Financial Oversight Council, unfortunately its proposed membership is comprised of almost everyone who failed to regulate the previous crisis i.e. the US Treasury, the heads of the Federal Reserve, the National Bank Supervisor, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Consumer Protection Agency, and the Federal Housing Finance Agency.

In general, the Obama Administration's proposals for regulatory reform have been criticized because they are viewed as a product of the "same sort of groupthink that helped produce the crisis. In fact, the group does not seem to have changed, with the [Report] largely a product of the community of regulators that

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[17] Food crisis and the global land grab website; http://farmlandgrab.org/

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failed to prevent the current crisis[18]". Moreover, there seems to be little effort to "…re-examine fundamental assumptions or to consider the possible consequences if those assumptions are wrong.[19]" It appears that "…ideas and concerns from outside of the narrow consensus are being ignored as they were prior to the onset of the crisis.[20]" This "groupthink" has been viewed by some as a major dynamic that contributed to the escalation of systemic risk in the U.S. financial markets (since the beginning of the 2000 decade) ultimately leading up to the current crisis. For example, "…bank executives and regulators ignored dissenting voices which were questioning the excesses that were building up in the system. What was once a comfortable consensus about the strength of our regulatory structure perhaps is now at work by an equally comfortable and perhaps equally flawed consensus about how to fix it.[21]"

3. The White Paper Proposed to Increase the Powers of the Federal Reserve

The White Paper proposed that the Federal Reserve be given "…new responsibilities to supervise all institutions that could represent a threat to financial stability, even those that do not own banks.[22]" While understandable on one level it is also disturbing as this crisis was, in part, largely due to mismanagement of Fed monetary policy and regulatory failure. We have had historically low interest rates (since the mild recession of 2001) and an absence or lack of prudent regulatory supervision of financial institutions. The Fed failed to recognize the bubble created by high-risk mortgages and high-risk mortgagors between 2001 and 2006. The Fed Reserve also failed to recognize for a long time that easy access to high-risk mortgage loans, second mortgages, and home equity loans allowed investors and families to push up home prices to unsustainable levels. The Fed and the other banking regulators did nothing to rein in the poor underwriting of high-risk mortgages. Every federal and/or state regulator waited far too long to criticize interest-only mortgage loans and payment-option loans that allowed unpaid interest to be capitalized to loan principal. Thus, in retrospect, some Congressional and public pressure on the Fed for its recent past performance is warranted including questioning the enhancement of future powers without some reconciliation of the recent past.

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[18] Kling Arnold. "Obama Administration Proposals for Financial Regulatory Reform: A Critical Audit", FinReg21 website, July 20, 2009.
[19] Ibid.
[20] Ibid.
[21] Ibid.
[22] Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.

4. Most Recommendations Have not Followed the Trend Towards Supervision Consolidation

The 2009 White Paper and other signals from the Obama Administration have indicated that they are not following the "…trend towards supervision consolidation despite the fact that the crisis made it relatively evident that the fragmented supervisory setting can be incapable of monitoring the integrated, interconnected, and complex reality of US financial markets.[23]"

The Administrations proposals endorsed "interagency cooperation instead of agency consolidation[24]". Albeit, it should be noted that few theoretical studies in the economic literature have considered the "…US policymaker objective function in designing the financial supervision regime.[25]"

A 2008 empirical paper[26] suggested a probable connection between "multiple-authority regimes and bad governance practices[27]." In regards to the connection between "… bad governance and supervision, the study interprets the latter as a possible way of compensating lobbies (vested interests) with power, in a setup where rent-seeking behavior involves reciprocal string-pulling. Hence, more rent-seeking politicians will seek to create more institutions (or leading positions) in order to please all interests in terms of power and future connivance.[28]"

Criticism of the White Paper also revolves around creating more central bank fragmentation by increased the role of the Fed, i.e. "…as the degree of consolidation has shown to decreases while the central bank's involvement in supervision increases.[29]"

The White Paper's preference for supervision consolidation (via increased Fed authority) has been assailed by many, including an alliance of institutional and private investors, industry analysts, and former regulators who "…criticized

[23] Leijonhufvud, Alex. "Curbing instability: policy and regulation," CEPR Policy Insight 36, July 2009; and Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.

[24] Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.

[25] Ibid.

[26] Dalla Pellegrina, Lucia & Donato Masciandaro. "Politicians, central banks, and the shape of financial supervision architectures," Journal of Financial Regulation and Compliance, Emerald Group Publishing, vol. 4(4), November 2008, pages 290-317.

[27] Ibid.

[28] Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.

[29] Ibid.

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the central role of the Fed in this plan, proposing an alternative institutional option – the establishment of a new Systemic Risk Oversight Regulator, with a full time staff led by a chairman and four members appointed by the President and confirmed by the Senate, accountable to Congress[30]."

5. Macroeconomic versus Microeconomic Supervision[31]

The Obama Administration seems to say that they have a "new" formula for macro-economic supervision. The experience of these past few years has stressed the importance of overseeing systemic risks i.e. "…monitoring and assessing the threats to financial stability arising from macroeconomic developments in the economic and financial system as a whole (macro-prudential supervision).[32]" Therefore, "…it is now clear that central banks are in the best position to collect and analyze this kind of information, given their role of managing monetary policy in normal times and acting as the lender of last resort function in exceptional times.[33]"

But what about micro economic supervision, such as, moral hazard risk, conflict of interest risk, powerful bureaucracy risk[34]? "In other words, the separation between micro and macro supervision can be used to reduce the arguments against central bank involvement. It is possible to have consolidation in micro supervision without any reduction of the central bank involvement in macro supervision. This was, however, not the case as policymakers chose to maintain supervisory regimes where there are already many authorities.[35]" A possible political economy explanation of the "…conservative behavior of politicians, notwithstanding the crisis, is that they considered the expected benefits of reducing fragmentation to be less than the expected gains from political and bureaucratic consensus in maintaining the status quo.[36]"

[30] "Coalition to attack plan for Fed powers" Financial Times, 15 July, 2009; and Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.
[31] Masciandaro, Donato and Marc Quintyn. "Regulating the regulators in the US: The conservative proposal of President Obama", Financial Reform Project, The Pew Economic Policy Group, August 1, 2009.
[32] Ibid.
[33] Ibid.
[34] Ibid.
[35] Ibid.
[36] Ibid.

6. Government in the Financial Markets and Industry

Currently policymakers will have to balance two opposing risks, that of the risk of prolonged depression and stagnation versus the risk of a loss of confidence in government solvency. Moreover, there seems to be no real strategy to disengage the U.S. government from the key markets in the economy. The question that perhaps needs to be asked is that "is it even feasible for the U.S. government to pull out of certain sectors of the marketplace in the short-mid run?" There has been increased public spending in the private market by all G-7 countries. In 2009, $12,000 billion was issued in sovereign debt (sovereign bond issuance) by western developed economies. Public participation in the private sector has increased significantly in the past year. Perhaps a visible disengagement is doable in the global banking sector as opposed to other industrial sectors, but even that is somewhat questionable. For example, of the 50 largest banks in the U.S. and the European Union (EU), 23 and 15, respectively, have received public capital injections; that is, banks representing respectively 76% and 40% of pre-crisis market capitalization depend today on taxpayers (see Table 4). Other sectors, such as the automobile and insurance industries, have also received public assistance[37].

Table 4
U.S. and EU Banks Receiving Pubic Funds
(Size of public recapitalizations (percent of GDP))

Country	Capital Injections In Banks	Maximum Sum Announced To Be Allocated To Capital Injections	Total
Switzerland	1.2%	0%	1.2%
France	1.3%	1.1%	2.4%
Austria	1.5%	3.5%	5.0%
Germany	2.0%	1.5%	3.5%
U. S.	2.4%	3.6%	6.0%
U. K.	2.9%	0%	2.9%
Ireland	3.8%	0%	3.8%
Belgium	3.9%	0%	3.9%
Netherlands	6.2%	1.3%	7.5%

Source: Pisani-Ferry, Jean and Indhira Santos. "Reshaping the Global Economy", Bruegel Policy Contribution, Issue 2009/14, March 2009. Data Sources: IMF, US Treasury, European Commission, National Governments, and Bruegel calculations. Note: Data as of Feb. 11, 2009. Amounts restricted to Tier 1 capital injections. The starred countries did not specify a maximum amount of total intervention.

It should be noted that a strategy to ensure fiscal solvency is need for all the G-7 countries. The IMF promotes fiscal solvency to be based on the following

[37] Pisani-Ferry, Jean and Indhira Santos. "Reshaping the Global Economy", Bruegel Policy Contribution, Issue 2009/14, March 2009.

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four pillars: "(1) fiscal stimulus packages should consist as much as possible of temporary measures to avoid raising deficits permanently; (2) policies should be cast within medium-term fiscal frameworks providing for fiscal consolidation, once economic conditions improve; (3) governments should implement structural reforms to enhance growth prospects, and (4) a clear plan for reforming pension and health entitlements is needed to tackle long-run pressures arising from population aging.[38]"

7. Better Global Financial Supervision & Regulation

To date there has been no real international standards implemented except reinforcing the oversight committee (the Basel Committee on Banking Supervision (BCBS)[39]) in the Bank of International Settlements (BIS). Moreover, the crisis has shown that the U.S. needs better coordination with its European Union (EU) counterparts. This is particularly true of the United Kingdom whose financial markets are closely tied to the U.S. financial markets. For example, the vast majority of Citigroup's offshore trust business is done with the Royal Bank of Scotland, which was bailed out by Gordon Brown for over $300 billion.

The coordination with the EU is imperative for a global recovery because the EU does not have a single fiscal authority like the U.S. and, therefore, is unable to conduct an European-wide stimulus. Given the EU's significantly more rigid corporate governance market structure (especially in relation to its labor markets) this is very troublesome for the future economic stability and employment outlook for Europe. The EU did not even manage to conduct an Euroland euro-wide rescue-stimulus package. It was every country for itself and the non-euro countries, in particular, were flying without any safety nets in this crisis. This is particularly dangerous because of the western European financial industry's stake in its eastern neighbors (see Table 5 and 6).

[38] Cottarelli, Carlo. "Paying the Piper", Finance and Development, IMF, Vol. 46, No. 1, March 2009.

[39] The Basel Committee on Banking Supervision (BCBS), at the BIS, is a committee of bank supervisory authorities from the G-10 countries.

Table 5
Controlling Stake Of The Banking System In Central And Eastern Europe Owned By Western European Banks (asset share of foreign-owned banks, percent, 2007)

Bulgaria	82%
Czech Republic	84%
Estonia	99%
Hungary	64%
Latvia	63%
Lithuania	92%
Poland	77%
Romania	86%
Slovak Republic	99%
Slovenia	30%

Source: European Bank for Reconstruction and Development, 2009.

Table 6
Claims of West European Banks on East European Countries (US$, million)

	Austria	Belgium	France	Italy	Germany	Switzer-land	Greece	Sweden	Nether-lands
Poland	17236	25208	22858	54360	55413	8609	39	8092	41222
Czech Rep	65135	56709	38550	18956	12692	1266	0	159	6201
Russia	23922	10310	34713	25695	49506	19051	855	9859	25543
Hungary	38262	18676	11888	29326	37865	872	139	337	5577
Romania	46457	1185	17640	12948	3784	9079	20281	159	10999
Croatia	25126	413	8723	34832	19144	173	260	8	197
Slovakia	33234	10899	6447	23857	14152	75	0	156	6690
Ukraine	12927	761	10638	4920	4991	6989	905	5367	3700
Bulgaria	5749	2032	3555	8156	2803	6849	10835	39	689
Estonia	293	93	125	407	1054	45	0	32761	18
Lithuania	292	85	435	731	3771	379	1	28870	144
Latvia	803	25	360	1371	4761	51	32	24996	22
Kazakhstan	619	621	1301	696	3647	3075	48	273	2546
Sum in USD	***270,055***	***127,017***	***157,233***	***215,985***	***213,583***	***56,513***	***33,395***	***110,986***	***103,548***

Source: Taken from the BIS website: http://www.bis.org/statistics/consstats.htm#, March 2008.

8. Too Big To Fail?

Although former U.S. Treasury Secretary Hank Paulson under the Bush Administration helped curb the moral hazard of the "too big to fail" syndrome with the explicit decision to allow Lehman Brothers to fail, the Obama Administration has done very little, if nothing, to address this issue since then. No real standards implemented except the aforementioned additional imputes in the oversight committee in BIS.

9. Obama Administration's PR Debacle

There has been a growing expediential momentum at an astonishing rate of the loss of confidence, over a very short period of time, of the Obama Administration's political capital and public goodwill. This is truly unsettling given that just one year ago they had historical levels of goodwill and capital.

Even the most ardent supporters are openly questioning the achievements of the Administration in the midst of the sublimely ironic move by the Nobel Committee to bestow the new president with the Nobel peace prize. To his credit, President Obama, to the best of his ability, given the circumstances, accepted it humbly while claiming to not have deserve the prize - yet.

Given that we are an advanced media centric society, the new Administration's lack of savvy in managing their PR has been more than a bit disturbing especially given their savvy in the pre-election period with technology and young voters. The Administration has given most of us the perception that they are seemingly in their own vacuum of "*transcendental intellectualism*." Even seemingly obvious PR hot points were allowed to be mishandled. An example is managing the issue of Wall Street bank bonuses, albeit both a tricky and prickly issue, as we are not sure we want revamp our New York banking model while trying to maintain a small shred of lassize-faire in this industry in the aftermath of the financial bailout, and that we do not want to "throw out the baby with the bathwater."

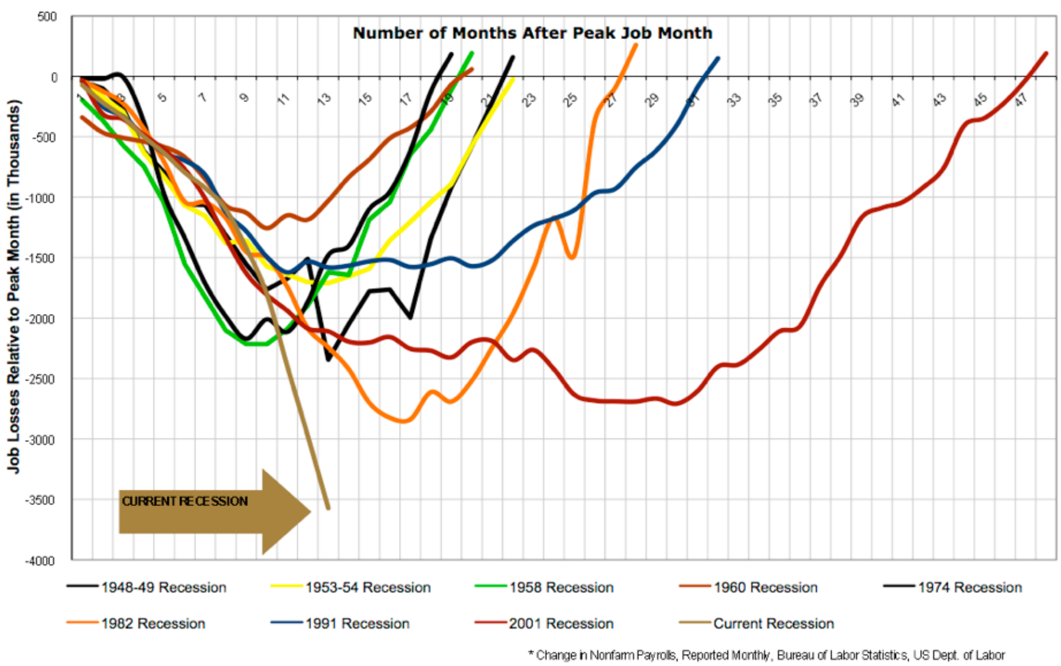
However, the recovery of big banks on Wall Street posting historic profits stemming from their commercial banking activity (and not the retail banking sector) has caused a huge political gaff for the Administration. The Administration seems to be baffled by what to do next as the banks are recovering, posting profits, and returning TARP money as fast as possible so as not to be hampered by special government regulators. The Administration cannot seem to articulate an answer to public's concerns and questions as to why the banks have used the tax payers bailout money to buy cheap assets (other banks and expand business and grow bigger), simultaneously handing out good size bonuses while there is still no substantial change in lending for the retail customers and small businesses. It should be noted that in a market economy you cannot force banks to lend as it results in more problems down the road.

It should be noted that the public was doubly concerned as the private credit business (i.e. credit cards) accelerated their predatory practices (i.e. changing credit limits (lower) and the charging customer, higher rates, worse terms…etc). This issue, however, has been addressed to a large degree by the

Administration. There is also no real discussion of the commercial real estate sector by the Administration despite the fact that everyone can see this sector failing and still trying to find its bottom.

Although we are experiencing a slow recovery there has been little relief in the job market where the official unemployment is near 10%. It should be noted, however, that we have had a 0% job creation in last 2000 decade. The crisis (which squarely occurred under the watch of the Bush Administration) has left us with the worst post-war job loss episode (see Figure 3). The current joblessness has battered us amidst a crisis that has hit the soft underbelly of the American economy – that of the economic middle (lower and upper) class. Many in this income bracket lost between 20%-40% of their pensions, retirement, savings and investments accounts literally overnight. This is a lot to absorb. It most devastated the middle class over the age of 55+ as their losses will never be recovered in full during their lifetime. Middle class Americans that are close to retirement or have already retired have to now lower their actual standard of living during their retirement age for remainder of their lives. This has also deepened the necessity of a speedy health care reform.

Figure 3
Job Losses* in Post WWII Recessions



Source: Ritholtz, Barry. "Job Losses in Post WWII Recessions", The Big Picture website, February 9, 2009.

10. We Better Have Something to Show after Spending $1.4 trillion plus

It is clear from a mid- to long-term economic perspective that the American economy better have something to show (i.e. increased global competitiveness) after we have spent over $1.4 trillion to shore it up. The projected budget deficit is at an all time record high of approximately $1.4 trillion for 2009 (9.9% of GDP) and the 2009 est. national debt is $12.1 trillion (approximately 90% of GDP). See Table 8 and 9.

Table 8
Government Bail-Outs And Stimulus Packages, October 2008 To January 2009

Country	$ Billions per country	$ per head of population
United States	1,600	5,928
Britain	1,080	17,705
China	500	385
Spain	150	3,750
Germany	67	817
France	50	806
Hungary	25	2,500
Ukraine	16	348
Iceland	10	33,000

Source: "The Banks: Bankrupting The World", NewInternationalist website, April 2009. Data from IMF.

Table 9
American Recovery and Reinvestment Act of 2009

Tax Relief	$288 Billion
State and Local Fiscal Relief	$144 Billion
Infrastructure and Science	$111 Billion
Protecting the Vulnerable	$81 Billion
Health Care	$59 Billion
Education and Training	$53 Billion
Energy	$43 Billion
Other	$8 Billion

Source: Ditzel, Jim. "American Recovery and Reinvestment Act of 2009 and Commercial Real Estate" CameraHomes website, September 21, 2009.

CONCLUDING REMARKS

The Obama Administration has not specifically addressed how it is going to create and shepherd the issue of mid- to long-term economic productivity as they continue to emphasize putting out current, albeit important, fires i.e. joblessness, healthcare reform, etc. But we must have a very frank and specific discussion of how of ensure results that will yield increased American productivity and American productive capacity in the next decade given the amount we have spent investing to shore up our current economic model.

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