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Opinions

What Obama should do now: Make the financial system safer

By Anat Admati
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President Obama came into office on the heels of the worst financial crisis since the Great Depression, and he called for reform of "the outdated rules and regulations" that allowed "the recklessness of a few to threaten the entire economy." While the Dodd-Frank financial reform law he signed gives regulators more authority, as it's currently implemented it will not prevent another massive collapse. Without constricting the economy's growth, the president can do much more to create a safer banking system.

To this end, one critical decision is the choice of his next Treasury secretary. The president must pick someone who has shown commitment to effective financial reform. This person should defend the public interest over the interests of the financial industry.

An excellent candidate would be Sheila Bair, who led the Federal Deposit Insurance Corp. from 2006 to 2011. Her resistance to the flawed regulations proposed by the international Basel Committee in 2004 helped prevent FDIC-insured banks from becoming as vulnerable as European banks and U.S. investment banks in the run-up to the financial crisis. Basel's rules, which control the extent of banks' borrowing, encouraged them to load up on investments that regulators saw as safe, but that were actually risky and led some banks to fail and others to be bailed out.

Other candidates who could press for financial reform with more teeth would be Gary Gensler, head of the Commodity Futures Trading Commission, who is trying to improve the regulation of derivatives, and Bill Bradley, who, as a senator, was involved in removing distortions from the tax code.

President Obama knows how flawed our financial system is. For example, in April 2009, he noted that before the crisis, "banks took on more debt than they could handle" and that there was "almost no accountability or oversight from anyone in Washington."

The new regulations that banks are fighting still allow them to borrow too much, and they have the same flaws that Bair saw in previous regulations and that became evident to many in the crisis.

An easy step to strengthen the financial system would be to ban banks, particularly the largest ones, from making any payouts to their shareholders until they are better able to absorb losses without going into distress. Instead of paying dividends, banks could use that money to make loans or other investments, or to repay some of their debts. Shareholders would still be entitled to all the returns from the banks' investments — as long as the debts were being paid. Such a rule would ensure that, should the banks incur losses on their investments, they would still be able to pay their debts and make loans. It would prevent taxpayers from bearing the risk of banks' investments and would make it less likely that the banks could drag down the economy.

A Treasury secretary focused on the public interest would also not be overly persuaded by arguments that our banks must be globally competitive. Europe is not an example to emulate, and the citizens of Ireland and Iceland paid dearly for their banks' global "success."

As Sen. Dick Durbin admitted in 2009, bankers "are still the most powerful lobby on Capitol Hill. And they frankly own the place." In his second term, Obama should step up and make sure that, instead, the public owns the place.

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