Government Regulation of Business, from the New Deal to the Stimulus—a Primer

There has been an ongoing debate for just about a century regarding the role of government in regulating business and finance, and the effect of such regulation on our national economy. In fact, this subject has been hotly contested since the days of Alexander Hamilton and Andrew Jackson, and then Theodore Roosevelt and Woodrow Wilson, and it became the centerpiece of Franklin D. Roosevelt's New Deal.

To better understand the complexities of this issue, we should look at its history and evolution, particularly as we again debate the subject in the run-up to the 2016 presidential election.

Senator Bernie Sanders of Vermont comes as close as any of the 2016 presidential candidates to bearing the title of "New Deal Democrat." He has described income inequality as the primary source of what is wrong with America today and has characterized everyday Wall Street activity as greedy and corrupt. He has called for the re-implementation of the Glass-Steagall Act of 1933, a New Deal financial reform that dichotomized the investment and banking functions within the nation's financial institutions. He has pledged to break up the country's largest banks, regulate business activity, and impose a federal tax on speculation as a means of leveling the economic playing field in the United States. These measures would surpass even some of the most aggressive New Deal initiatives.

Senator Sanders decries the influence of big money on U.S. political campaigns and considers the Supreme Court's decision in the Citizens United case to be the greatest blow to democratic processes in the nation's history (the 2010 Citizens United decision allows unlimited political spending by individuals, unions, and corporations). He advocates holding CEOs and bank executives accountable and maintains that no bank is too big to fail and no CEO too powerful to avoid jail. He has repeatedly denounced the depths of income inequality in the U.S. while stating that America's wealth is controlled by the top 10 percent of 1 percent of its population.

Former Secretary of State Hillary Clinton shares many of Senator Sander's views but does not think a return to Glass-Steagall is necessary. She has said that the Dodd-Frank Act of 2009 has provided the president with sufficient powers to regulate the financial industry and to break up the big banks. Mrs. Clinton agrees that wayward bankers and Wall Street CEOs should be held accountable and sent to prison when circumstances require.

Businessman Donald Trump has said he would impose greater taxes on the hedge fund industry and indicates that his insider's view of how business and finance really work would make him uniquely qualified to address the relationship of government to business, if he were elected president.

Texas Senator Ted Cruz proposes a return to Reagan-era deregulation and economics, and Ohio Governor John Kasich takes a similar position, calling attention to the important role he played as chair of the House Budget Committee during the Reagan and George H.W. Bush administrations.

This article provides an overview of regulation over the past 84 years and highlights the impact of various degrees of government regulatory policy concerning business, with a focus on the more recent events that have brought us to the present-day debate.

Background

Investigations, administrative actions, and prosecutions in the early part of the new millennium concerning Enron, World Com, Adelphia, Marsh & McLennan, AIG, Health South, and other corporations created another swing in the regulatory and law-enforcement pendulum concerning the oversight, regulation, and prosecution of business and financial conduct in the United States. The need for more oversight became even more obvious with what would soon follow—the 2008 subprime mortgage crisis and near collapse of the global financial industry—which seemed to take everyone by surprise except for the industry players who created the turmoil.

During that time, corruption in the marketplace and public outcries for government action led to the conclusion by many that self-regulation had failed and that federal prosecutors and regulators should take dead aim at corporate America, in particular banks and the financial industry. In mid-2006, the Senate Judiciary Committee began to consider legislation to stabilize business and entrepreneurial activity by striking a proper balance between criminal and civil enforcement practices.

America has swung back and forth from the laissez-faire approach of the 1920s, to the redefinition of capitalism that was the New Deal, to the growth of the national bureaucratic and regulatory framework of the 1960s and 1970s, to “Morning in America” Reagan-era deregulation of business in the 1980s, to present-day demands for accountability and control over Wall Street and the financial industry.

Franklin Roosevelt and the New Deal

Government regulation of business, as we have known it in modern times, began in earnest in 1932 with the onset of Franklin D. Roosevelt’s New Deal. F.D.R had strong intellectual and ideological ties to the “trust busting” principles and policies of his cousin Teddy Roosevelt and President Woodrow Wilson, in whose administration F.D.R. served. T.R.’s steadfast efforts in regulating and controlling the corporate and business behavior of his day and Wilson’s philosophy of controlled capitalism were indeed the foundation of New Deal regulatory philosophies and served as the paradigm for all government regulation to follow.

By 1929 it was starkly apparent that self-regulation had failed. Cloaked in the blanket of the free market system, Wall Street had gone fully unregulated. Businessmen made fortunes by gaining full, unscrupulous advantage over a wide-open, unaccountable financial system. Banks failed and mortgages defaulted in the thousands, threatening farms and homesteads alike. Jobs became scarce. Basic necessities of life were left unmet, and breadwinners were begging for jobs and food on the streets. Trust in the government was at an all-time low, and regard for the entrepreneur and businessman nonexistent. Families were broken and lives ruined. It became incumbent upon the government to begin a course of action that would establish core values in overseeing business conduct and would ensure proper business practices and behavior and a fair and equitable national economy.

The “Great Juggler,” as Franklin D. Roosevelt described himself, was elected to the American presidency by a landslide in 1932. The situation at the time was no cyclical aberration in the economy, as the incumbent Herbert Hoover had insisted. It was endemic international collapse of the capitalist system, which, unlike the financial crisis of 2008, had its underpinnings in the European arena. F.D.R. had two choices—preside over the collapse of American capitalism and the onset of socialism or modify capitalism in order that it survive. Modify he did, and the first hundred days of his administration would set the standard for accomplishments for new administrations for generations to come.

Roosevelt assembled a “brain trust” of legal, financial, and political operatives, largely from the East Coast and academia. Faced with massive withdrawals of funds from banks, bank failures, and an avalanche of mortgage foreclosures on homes and farms, he issued an executive order declaring a “bank holiday,” and another declaring a moratorium on bank foreclosures. These extraordinary steps were stopgap measures to give his administration time to propose the legislation to create the massive federal bureaucracy that would be required to implement legislative delegations of power to the new president to act on such problems.

The financial and business markets were directly affected but relieved that action was being taken. Wall Street was horrified, as were bankers, who referred to the new president as “that man Roosevelt” and “a traitor to his class.” The president used his “fireside chats” on radio to explain the bank holiday and moratorium to a frightened public and, as humorist Will Rogers would later comment, did so with such clarity and simplicity that “even the bankers understood it.”

Undaunted, Roosevelt pressed on and lobbied in his weekly radio addresses, giving hope to a people starved for action. Pure necessity and public opinion brought about in short order the development by the Supreme Court of practical constitutional standards by which Congress could delegate legislative power to the Executive. Initially, the Court began to uphold the creation of the New Deal regulatory apparatus by requiring Congress to include “standards and guidelines” as well as “intelligible principles" in legislation delegating its authority to the Executive Branch and to that branch's departments and agencies. One of the first agencies created was the Securities and Exchange Commission, under the Securities Act of 1933, to address and correct the excesses of Wall Street that had caused the crash of 1929.

As F.D.R. advanced to his second term, the justices would take a stricter stance on Congress's ability to delegate power to the Executive Branch, and the Court began to curtail the latitude it had extended to create the earlier New Deal agencies. In response, Roosevelt proposed legislation to increase the number of justices on the Court so that he could appoint New Deal-friendly members. In a rare instance of the Congress saying no to F.D.R, his "court packing plan" was defeated, with one Senator commenting, "This is more power than a good man should want or a bad man should have."

Leaving no doubt about his resolve to enact and enforce serious regulation and control over the securities industry, Roosevelt appointed Wall Street financier Joseph P. Kennedy, who had a reputation as a hard-bitten and ruthless operator, to be chairman of the S.E.C. Roosevelt nonchalantly commented that in appointing Kennedy he indeed wanted "Brer Rabbit in charge of the cabbage patch."

Kennedy did not disappoint Roosevelt. The S.E.C was organized, staffed, and empowered to deliver practical and substantive procedural and operational reform to the securities and financial industries. By the time Kennedy resigned to make way for his successor, William O. Douglas, he had substantially succeeded in halting abuses, establishing strong mechanisms for accountability and control, and winning the respect of industry operatives.

Roosevelt would soon accomplish similar results in the areas of banking, communications, trade, transportation, commerce, insurance, food and drugs, environment, labor, and industry. Congress made progress in providing the oversight of the new agencies and the bureaucracy it had created, but could scarcely keep up with the resulting mountains of rule-making and policy requirements.

With the help of the mobilization for World War II, the Depression was subdued, and a new regulatory framework was firmly set into place, often including industry players in regulatory and oversight roles, which up to the 1980s had kept the economy in check and altered American capitalism forever. One of the most important reforms of the New Deal era was the Glass-Steagall Act of 1933, which required separation of the commercial banking and securities business within banks. The intermingling of these functions had played a significant role in the collapse of the American banking system after the 1929 stock market crash.

Post-New Deal Policies

Every successor to Franklin D. Roosevelt, Republican or Democrat alike, up to Ronald Reagan, not only failed to reduce the size of the Federal Government and reverse the New Deal, but in fact expanded it. For the most part, these policies succeeded. While a bloated bureaucracy had indeed been created, and Congress had blatantly, and most likely unlawfully, delegated much of its power to the chief executive, the economy grew in unprecedented fashion, and the defects in the regulatory system that resulted in the collapse of 1929 were rectified.

Banks were now safe places to deposit money and to obtain and maintain mortgages. Wall Street knew and adhered to the rules. Trade, communications, and labor were placed in a sound framework of accountability. Programs like the W.P.A. and C.C.C. created real work and self-sustaining jobs, and a system of financial support for the elderly (Social Security) was firmly established. Once and for all the principle was established that government was the appropriate entity to enforce integrity and transparency in the market place and to provide the social safety net that every moral society must secure for its people.

Critics came and went, but no one tampered with the new capitalism. Self-regulation had failed, and this was underscored by the fact that no one in the banking and finance industry, pre-New Deal, admitted or called attention to the serious problems that existed prior to the 1929 collapse. Our 2008 scenario was eerily similar.

With only two possible exceptions—Ronald Regan and Bill Clinton—presidents from F.D.R. to Barack Obama have not only resisted pressure to reduce the federal regulatory apparatus but have increased it and relied heavily upon it.

From Truman's Fair Deal to LBJ's Great Society

President Harry Truman, who succeeded F.D.R. after his death in April 1945, expanded federal authority over labor and production, literally nationalizing the steel industry. Dwight Eisenhower, who campaigned on a platform of dismantling the New Deal bureaucracy, actually enlarged it while the economy expanded and Wall Street flourished. His main legacy was the creation of the nation's interstate highway system. John F. Kennedy and Lyndon Johnson continued to centralize power in the Federal Government, and like Roosevelt, used government proactively to regulate the economy and provide a safety net for those left behind in the American post-war expansion. Kennedy's economic initiatives included a tax cut that stimulated economic growth. Johnson's Great Society surpassed even the New Deal's social programs, and Medicare, its centerpiece, to this day stands as perhaps one of the most significant government-sponsored assistance programs in our history (not even F.D.R. would take on the American Medical Association). The masterful Johnson, however, hoodwinked the doctors by initially coaxing them into agreeing to provide medical care for Third World senior citizens and then publicly extending the proposition to include the introduction of Medicare in the United States.

Richard Nixon and the New Federalism

Richard Nixon, known for his skill and attention to foreign policy, produced great domestic social achievements in the economy by furthering the federal bureaucratic role. He appointed a special domestic counsel and produced programs and reforms in the areas of intergovernmental relations, revenue sharing, and "the new federalism"—initiatives that stand to this day as some of the most progressive federal economic and domestic initiatives in the nation's history. Nixon, a free-market Republican, nevertheless kept and enforced New Deal agencies and laws and created new ones, such as the Environmental Protection Agency.

Ford and Carter, in the Short Term

Gerald Ford sought to utilize the federal bureaucracy to stop widespread inflation and to assist cities, including New York, which were teetering on bankruptcy. Ford's urban relief programs were grossly mischaracterized and maligned in the press and his accomplishments understated. Jimmy Carter continued the policy of strong federal involvement, especially in the field of energy. However, Carter's effectiveness in business and economic policy slipped considerably, with revelations of scandal surrounding the financial dealings of his budget director, Bert Lance.

Ronald Reagan's "Morning in America"

The first real attempt to follow through on a campaign promise to reduce the level, intensity, and size of the federal regulatory system was advanced by the affable but doctrinaire Ronald Reagan in the 1980s. His budget director, David Stockman, led the Reagan economic "brain trust." The Reagan Administration focused on banking, securities, and insurance regulation. Under Reagan's leadership, legislation was passed removing restrictions on federally insured banks wanting to expand into the insurance business and allowing federally chartered banks and savings and loans to engage in direct investments in the same real estate they were lending money on, with no personal guarantees from the borrowers. Self-regulation was back, it seemed.

The insurance industry was granted reciprocal latitude by the same legislation. The customary congressional oversight mechanisms to monitor these now lightly regulated industries was not utilized fully, and no study of the potential impact of the deregulation legislation on parallel Federal Deposit and Insurance Corporation claims was undertaken, nor were even the most fundamental provisions made for the eventual consequences. As in the pre-New Deal era, at no time did industry operatives call attention to the fact that there were problems requiring immediate remedial action.

Impact of Reagan-Era Deregulation of the Real Estate and S&L Industries

Commercial banks and savings and loans expanded rapidly into the real estate and insurance markets. This sacrifice of credit and collateral protection became a trade-off for the S&L's receiving "equity kickers," or profit participations, for commercial and real estate development loans. As a result, mortgages that would ordinarily require developers to maintain 20–40 percent cash “equity” in projects were approved and disbursed in excess of 100 percent loan of value. The same transactions, which had previously required extensive credit background checks and personal guarantees of principals and significant borrower net worth and equity contributions, were structured as purely asset-based transactions with no credit, personal guarantee enhancements, or borrower equity-stake requirements.

The banks justified these transactions on the basis of the project equity it negotiated with the developer and on appraisals, which reflected not the existing fair-market value of the properties on a “quick-sale” basis but property value as if and when it were approved, improved, operated, or sold. Vast amounts of savings and loan depositor moneys and life savings were advanced to developers on vacant land, prior to final approval of site plan and the procurement of subdivision requirements. “Hard and soft costs” of the project development were funded, leaving the developers and banks and their depositors at the mercy of the local planning and zoning authorities.

Loans were booked in massive amounts in this fashion for office and retail projects based upon projected, not actual, cash flow, and developers routinely front-ended their “development fees.” The savings and loans likewise extracted and booked fees at closing and entered on their books vast amounts of phantom income, based upon fees they had funded themselves from their depositors’ money and projected “equity” in projects that were not even close to the point of completion, profit, or value.

The S&Ls took their paper gains and sold their banks for sums equal to percentages over “revenue.” Officers, employees, directors, and shareholders were well rewarded by the resale profits, while uninformed depositors received notices that their banks had been purchased or absorbed by new institutions.

The residential mortgage market was equally affected. Due to the deregulation and elimination of conventional credit and equity requirements in the mid-1980s, S&Ls and commercial banks introduced the no-income, no-credit, and “jumbo” loans. Prices of residential real estate during this period soared. Increases of 75–100 percent in appraisals in a matter of a year or two were not uncommon. The flow of money from the new loan products heated up the market and inflated values. There seemed to be no end or limit in sight. Once again, banks sold their mortgage portfolios and stock at huge profits.

Relaxation of Securities Industry Regulation Under Reagan
On Wall Street, insatiable seekers of venture capital were swimming in cash raised by the invention and sale of “junk bonds” by individuals like Michael Milken. No rule, statue, or regulatory custom existed to prohibit the formation and sale of this particular hybrid security, and capital providers and recipients alike took while the taking was good. New businesses and industries abounded. Wall Street players made fortunes overnight, from the brilliant Milken to neophytes who barely had the experience to follow the paper flow. The trophy homes in Greenwich, Conn., as well as luxury cars, boats, and posh New York City condominiums were just some of the symbols of this accidental wealth.

Investors collected the bonds and relied on the authenticity of the presumed equity that backed them. Little or no appraisal or due diligence was conducted regarding the prospect of success of the businesses or the finances of some ventures, nor was there any meaningful review or administrative oversight mechanisms put into place to monitor ongoing operations and performance of the securities. Hedge funds, a rapidly growing source of private equity placement, were essentially free from direct administrative regulation. Former Federal Reserve Chairman Alan Greenspan cautioned Congress that these newly formed and capitalized companies lacked real basis in value.

The object of the game, as in the case of the commercial banks and S&Ls, was to generate fees and book phantom equity to support inflated stock or bond value. At the same time, budget deficits ran up at alarming rates, as did the national deficit. Supply-side economics and deregulation created an aura of entrepreneurial invincibility that seemed to have no end. It was “Morning in America” and no one seemed concerned over the economic nightfall that would soon follow.

Reagan Era, S&L and Insurance Industry Deregulation
By late 1989, commercial real estate failures and foreclosures soared at alarming rates. Similarly, residential mortgage loan foreclosures rapidly rose. By 1991, budget deficits and rising interest rates gave way to increasing unemployment and recession. Foreclosures increased significantly. Borrowers who had little or no equity in the real estate they had just handsomely paid for with depositors’ money abandoned their properties. Commercial lenders likewise took title to real estate they had permitted developers to “leverage out” on.

Banks and savings and loans rapidly took in “REO” (real estate owned) property in lieu of foreclosure. Bank inventories of commercial land developments, residential developments, and office buildings, as well as luxury and middle-range residential properties, accumulated dramatically. Markets were glutted with such properties placed on the market for resale by the banks. Real estate values declined. Properties valued at inflated prices at the time of loan origination were now routinely appraised and resold at values significantly below the amount of the principal of loans. Sound familiar?

For the first time since pre-New Deal days, the term “deficiency” had real meaning to lender and borrower. So foreign had this concept been, that banks such as Dime Savings Bank of Brooklyn, which pioneered the no-income, no-asset loan, became deluged with deficiency losses because its attorneys failed to observe applicable procedural requirements to preserve that bank’s residual rights against borrowers.

Banks such as the former Westchester Federal Savings and Loan in New Rochelle, N.Y., which sold its loans and stock to Marine Midland Bank of Rochester, were later discovered to be, for the most part, worthless depositories of bad paper. For the first time since the New Deal and F.D.R.’s declaration of the bank holiday, S&Ls began to fail at alarming rates. Commercial bank failures soon followed. The Federal Deposit Insurance Company was called upon to make good on substantial sums of depositors’ lost money up to the $100,000 limit on each institutional account. Attorneys who made it a practice to concentrate huge sums of client funds in the S&Ls lost vast sums of their funds that were uninsured in excess of the $100,000 threshold, triggering personal hardship for clients and professional liability for lawyers.

The F.D.I.C. and the Treasury Department’s controller of currency began to take control of savings and loans and commercial banks at a rapid rate, and Congress created the Resolution Trust Corporation (RTC) under the controller of the currency to take possession and control of the banks and their REO properties, which were accumulating. The RTC, having little or no staff or expertise in real estate development, marketing, or management, was staffed initially with deposed officers of Texas S&Ls, which were the first victims of the S&L debacle. The RTC grew in size and assets, as it spent and wasted billions of dollars in public money. It overpaid for goods and services, mismanaged properties, misdirected assets, and made wasteful and inefficient deals.

As in the days of the New Deal, those who preserved their liquidity made fortunes. Properties were bought on the cheap. Non-recourse borrowers, in default on their own now RTC-owned properties, frequently repurchased them from the agency at huge discounts, often reselling them for significant profits.

The F.D.I.C. began the process of forced acquisitions of weaker banks by stronger ones, which themselves became weak and were in turn swallowed up by mega-banks like Citibank and Bank of America. With some exceptions, usually in the form of well-managed privately owned state-chartered community banks, small to mid-sized banks became extinct. This was the breeding ground for what would become the "too big to fail" banks that the public came to know in 2008.

From all this, only minimal prosecutions like those involving Lincoln Savings and Loan and Silverado Bank followed. Indictments ensued for a period of time. The Silverado Bank defendants Michael R. Wise and Neil Bush were acquitted, though Wise would later go to prison for another scheme. Charles Keating of Lincoln Savings was convicted, only to have his verdict set aside by an appellate court some months later. Other sporadic prosecutions commenced, few convictions resulted, and prosecutorial interest in the banking, S&L, and RTC scandals waned.

"Reaganomics" and Wall Street

In December 1987 Wall Street suffered its greatest setback since the crash of 1929. The new companies and ventures fueled with deregulated junk-bond capital crashed as well. Michael Milken and others, who just a year before were hailed as innovators and champions of venture capitalism, were prosecuted and convicted on what amounted to borderline criminal activity, which, a few years earlier, had been considered cutting edge legitimate venture-capital tools.

George H.W. Bush and the Responsibility of Power

The Reagan attempts at deregulation resulted in serious economic reversals. The consequences of all this in terms of law-enforcement and regulatory action were remarkably light, low profile, and short lived. It fell to Reagan's successor, George H.W. Bush, to preside over the effects of the financial libertarianism of the Reagan era. The deficits were growing exponentially, S&Ls were failing in increasing numbers, unemployment was on the rise, and interest rates were escalating.

Not even Desert Storm could save his presidency from the effects of what he had so presciently labeled as "voodoo economics" in 1980. President Bush, seeing the handwriting on the wall and compelled to deal with reality, supported the Revenue Act of 1991, sponsored jointly by some Republicans and by Democratic Ways and Means Committee Chairman Dan Rostenkowski. The measure was passed and taxes were raised over a period of several years. Bush had flawlessly conducted and won a war but broke his "read my lips" pledge, raised taxes, and increased the federal bureaucracy with the failed Resolution Trust Corporation and its successor administrative structures.

For all this, President Bush lost the presidency to Bill Clinton, having laid the foundation for the economic boom to follow by creating the tax revenue that would fuel the Clinton recovery and launch an extraordinary period of economic growth.

Bill Clinton and the "New Democrats"

Bill Clinton was a master of the development and use of public policy. He used his appointments to the Treasury and controller of the currency posts, as well as many other high- and mid-level departmental and bureaucratic positions, to relax the national regulatory apparatus. He expanded the economy, eliminated debt, and promoted international and domestic entrepreneurial and business growth.

Building the Bridge

Clinton effectively used government to informally relax regulation and provide incentive for economic expansion. What is extremely noteworthy is that Clinton did not have a business background and by his own admission "never had a quarter" until he left government. His skill was almost academic in nature but very shrewd in practice. His annual "Clinton Global Initiative" conference continues to this day. He left it to his treasury secretary, Robert Rubin, and others to design and implement a plan for economic recovery. Rubin himself set the tone of quiet skill and a disdain for the trappings of the massive wealth he was so adept at helping to create. Clinton accomplished, with what seemed to be ease, the growth of the economy by promoting economic expansion and entrepreneurism and relaxing government regulation.

The results were by most accounts successful: elimination of the deficit, balancing of the budget, and expansion of the economy globally in unprecedented fashion, indeed fulfilling his self-described goal of "building a bridge to the 21st century."

Bill Clinton—Political Hybrid

Like all progress, Clinton's great expansion period had its costs. The Welfare Reform Act of 1996, a political tradeoff, essentially eliminated substantial portions of the social safety net created as far back as the New Deal, the Great Society, and the Nixon Administration. Eclipsing any Republican before him, Clinton outsourced jobs and minimized aid to families with dependent children, grants in aid, school breakfasts for inner-city children, and other traditional and innovative social welfare programs.

As difficulties mounted for the inner city and rural poor, Clinton's actions made life easier for Wall Street, investors, and the middle class to thrive. President Clinton's most significant and overt act in deregulating the financial industry was his signing into law of the Leach-Biley Act, which repealed the Glass-Steagall Act of 1933 and allowed banks to once again intermingle commercial banking and securities dealing. This allowed banks like Citicorp of New York and others to pave the way to the securitized mortgage business model that in turn brought us the subprime mortgage crisis of 2008.

Entrepreneurs and businessmen, especially in high-technology fields and the emerging "dot.com" industry that ultimately gave rise to enterprises such as Google and Facebook, made mega-fortunes with minimal government regulation. Republican businessmen privately worried that Clinton would be impeached over the Starr investigation and that "the party would be over," but Clinton survived.

George W. Bush, an Unlikely Destiny

George W. Bush had no trouble creating the single largest new federal bureaucratic structure since the New Deal, the

Department of Homeland Security. Politics, policy, and public passions—not partisan ideology—decree the use and extent of the government's regulation of business, law, and enforcement policies. Bush's attempt to alter the prize of the New Deal, Social Security, by converting a portion of it, for some future retirees, into individual investment accounts failed to even reach a vote in Congress in spite of his full use of the “bully pulpit” to generate public support.

As to the use of the regulatory process by the Bush Administration, the aftershock and government action following the tragic events of September 11, 2001, were compounded by startling revelations concerning the unraveling of Enron and other public companies and the unveiling of allegations of massive fraud in corporate accounting and reporting requirements. Eventually the investigations reached to the underlying transactions of the companies, in the form of limited partnership ventures, and to excessive executive compensation.

Beyond this, the activities, relationships, and compensation structures of the investment banking and service-related industries came under scrutiny along with the mutual fund and insurance industries. Washington and Wall Street were taken by storm. No one expected the wave of corporate crime and prosecutions that materialized at the time, and law enforcement was not sure how to deal with the situation.

Bush’s tax cuts of 2001 and 2003, especially for those earning $250,000 or more, were calculated to increase savings and investment, but people simply spent the money instead. Consumer debt reached an all-time high, and the income gap continued to grow between the top 1 percent and the other 99 percent of Americans.

The Bush Administration was busy at work attempting to protect and defend against terrorism and was caught fully by surprise by the enormity of the Enron and related scandals. Harvey Pitt, the Bush chairman of the Securities and Exchange Commission, had little inkling as to the depth and magnitude of the issues, and no suitable regulatory apparatus existed to deal with it at the time. Litigation, investigations, and prosecutions multiplied. Demands for corporate accountability appeared in the press daily, and great pressure was brought upon national law enforcement and regulatory officials to act.

The nature of the corporate wrongdoing or misdeeds can only be generalized here. Enron booked as assets and profits non-existing limited partnership interests, which were concocted by its management and executive teams or their operatives. The company's accountants were found to be complicit, were charged, and were made to pay civil penalties for their part in disguising and misstating corporate debt in order to exaggerate equity. Enron chairman/CEO, the late Kenneth Lay, and the company's former president/CEO, Jeffrey Skilling, were convicted on charges stemming from accounting and mail fraud. Enron CFO Andrew Fastow pleaded guilty and served a term of six years. Kenneth Lay died before his conviction became final and so it was expunged. The Supreme Court vacated Jeffrey Skilling's conviction in 2010.

Enron executives drew large salaries and bonuses, options, and fees in cash and stock. These corporate insiders sold stock immediately before the filing of chapter 11 proceedings. Shareholders and employees alike were hyped on the value of the stock, while the general condition of the company and the truth about its financial difficulties and distress were deliberately withheld. In the midst of it all, Enron's executives and operatives cashed in to the tune of hundreds of millions of dollars, while shareholders and employees whose life savings were invested in the company were misled and lied to. The company accountants directly participated in the wrongdoing and obstructed justice by destroying evidence in the process.

The regulators were asleep. SEC Chairman Harvey Pitt was accused of “not understanding his job” and for producing “structurally flawed analytical work,” and the Bush Administration of “representing the interest of the ownership class.” These were harsh words but difficult to dispute under the circumstances.

Although Enron’s ties to the Bush Administration were well known, the origins of the Enron-related activities in question dated back to the Clinton Administration, and Enron's executives were equally generous to both camps

Other Enrons

The WorldCom and other scandals were similar in nature and magnitude to Enron. Questionable accounting practices and failures to disclose to investors and employees the nature, extent, and weight of corporate debt rocked WorldCom, and the corporate bankruptcy filing was equally contentious. WorldCom CEO Bernard Ebbers was convicted of an $11 billion accounting fraud and lost his appeal. He was sentenced to a long prison term.

Officials of Health South Corporation were accused of bid rigging. Health South CEO Richard Scrushy was convicted in federal court in Birmingham, Ala., and like Jeffrey Skilling, his conviction was vacated due to the vagueness of the federal mail fraud statute under which he was prosecuted. A total of 15 Health South employees, including five former CEOs, pleaded guilty to taking part in a $2.7 billion accounting fraud. Canadian publishing magnate Conrad Black was also prosecuted and convicted under the federal mail fraud statute for theft of honest services. His conviction was vacated by the U.S. Supreme Court around the same time that the Court threw out the Enron convictions.

The Adelphia Cable Company scandals were even more direct and concentrated. Senior directors and major shareholders advanced themselves hundreds of millions of dollars in the form of unauthorized loans and direct investments and purchases from third parties. Tyco, another case of excessive diversion of corporate funds to executives as loans or compensation, was also a high-profile prosecution. Tyco CEO Dennis Kozlowski and CFO Mark Swartz were prosecuted by the New York County District Attorney and convicted of stealing hundreds of millions of dollars from the company for their own account and spent years in New York State prison before being released on parole.

Richard Grasso, former chairman of the New York Stock Exchange, was sued for excessive compensation, but his judgment was vacated when his attorneys, Williams & Connolly of Washington, D.C., challenged the government's case.

CEO Compensation

In the face of all of this, 2006 compensation and bonuses for CEOs on Wall Street were reported to be in the billions of dollars, so disproportionate to employee compensation and other American wealth achievement levels as to be unexplainable in moral or economic terms.

The entire mechanism and process of stock-option compensation to CEOs has now come under full scrutiny. "Change in control" provisions and monitoring CEOs when they trigger stock options, as well as a complete overhaul of ratios for CEO profit and compensation, are now being recommended. Recent reports indicate that CEO compensation is now leveling off and that more definitive guidelines for executive compensation are being established.

Investment Advisors and Profiteers

The investment banking and related investigations involved other more subtle issues that challenged the very nature of the transactions and the very core of the industries. The fundamental regulatory proposition is now that a firm engaged in the money-management business cannot have an investment banking arm because of inherent conflicts of interest, real or potential, but historically, investment-banking houses were part of a larger firm that engaged in the money market and securities business.

In the mid to late 1990s, bankers and money managers found themselves under investigation and subject to severe criminal penalties, as the public outcry over corporate corruption and greed prompted a government response. In order to avoid the prospect of regulators criminalizing what would traditionally have been considered civil matters, companies settled, agreeing to pay huge fines and eliminating any conflicting activities or divisions. Citibank, Merrill Lynch, and many others fell quickly into line. In some cases, offending executives and managers, like Citigroup's Sanford I. Weill, were banned from the industry by local regulators in their particular jurisdiction. Practices of predatory lending and overreaching had come under fire by regulators, and investment bankers were cited for failure to adhere to notions of fiduciary duty. A complete severance of the investment banking and securities functions is now required. Hedge fund managers, however, continued to operate essentially without regulation.

Revisionist Regulation

Late trading became the next taboo. An industry standard practice that existed for years, it was initially enjoined in 2005 and 2006. Hefty fines and consensual cease-and-desist orders were implemented, rather than the prosecution of the individuals involved.

The mutual funds industry was also affected. Marsh & McLennan agreed to pay enormous civil fines and enter into consensual cease-and-desist orders to avoid federal criminal prosecution. Regulators charged that insurance premiums were too high because insurance companies had formed illegal cartels, and that corruption was rife throughout the industry.

Practices such as timing of trades, as well as late trading fees and the over-charging of fees totaling some $70 billion per year paid as fee income to mutual fund managers were investigated, and regulators brought an $850 million lawsuit against Marsh & McLennan. The firm settled issues of civil and criminal liability with federal regulators for a $40 million sum (one year's fee income for the firm) and entered into a cease-and-desist order. The company did not acknowledge criminal wrongdoing but agreed to new management and leadership and to new transparent business policies. Contingent payments that had driven insurance fees way up were eliminated. However, in 2010 the convictions of the Marsh & McLennan executives were vacated by the convicting New York State court on grounds of unlawful disclosure violations by the prosecution.

In all of these instances, the majority of the enormous fines paid were not distributed to clients or investors but rather kept in the government coffer.

When Horatio Alger Became Jesse James

Some have said that white-collar, post-Enron law enforcement policies created an environment of selective prosecution, an insufficiently defined statutory and regulatory apparatus, and an enforcement model that would gradually have the effect of criminalizing ordinary commerce.

CEOs are now called upon, under penalty of criminal prosecution, to guarantee the accuracy of financial reports. Accountants and attorneys are directly in the fray of derivative and direct criminal liability.

AIG CEO Maurice Greenberg's resignation was demanded and received in 2005 after it was alleged that he had personally initiated a complex, questionable transaction that regulators believed boosted AIG's earnings. Greenberg and his successors invoked the Fifth Amendment in the face of investigation of the company concerning earnings manipulation. A New York State court vacated the judgment when Greenberg's attorney's successfully challenged the government's case.

The slippery slope of post-Enron regulatory and law enforcement was in full swing. Indeed, a *New York Times* article of October 29, 2006, said that "Congress now recognized the need to strike a balance between civil and criminal sanctions imposed on business practices." New theories of criminal culpability replaced previous industry practices, while aggressive prosecutors promised investors retribution, reform, and compensation.

Indentured America—the Subprime Mortgage Crisis

Incredibly, with all of these cases, controversies, and difficulties still underway, bankers and brokers, with the help of regulators, developed the "subprime mortgage" beginning the late 90s in an ambitious effort to expand home ownership and mortgage borrowing. This went beyond the relaxed standards of the ‘80s and set the stage for the mass borrower defaults that followed. These new products utilized appraisals that were based on inflated property values that were in turn based on distorted valuations proffered by portfolio-driven lenders. Because values kept rising with each distorted sale, lenders had no problem recovering properties from defaulting borrowers or avoiding foreclosure by reselling properties, making new distorted loans. Subprime lenders lured borrowers with variable-rate mortgages that began with affordable payments that later spiraled into impossible burdens. Quasi-federal entities such as Fannie Mae and Freddie Mac not only failed to ensure that these transactions were sound but also joined in the speculation and floated huge revenues, fees, and profits in the process.

To make matters worse, as the Clinton recovery advanced, Wall Street bankers applied “new age” academic theories that they used to package or “securitize” millions of devalued subprime mortgages into insured debt instruments to be sold and re-sold in the private and public equity markets. In the process, essential loan-origination documentation and transfer instruments went unaccounted for and in many cases were never placed on public records as required by statute. Again, inflated home values, fueled by made-to-order appraisals on questionable loans, enabled the banks to sustain the momentum in the marketplace and satisfy the regulators by refinancing bad paper or strictly foreclosing on defaulted loans and reselling the properties for sums sufficient to liquidate the defaulted debt.

This all came to an abrupt end in the late 2008 when rapidly increasing oil prices and other economic factors created a spiral of mortgage defaults that trashed not only the underlying mortgage debt but also the securitized packages purchased by the investment bankers and guaranteed by the insurance companies. The entire financial system was at the brink of disaster. Bush Treasury Secretary Henry Paulson advocated immediate federal intervention to bail out the banks, investment houses, and insurance companies as the only way to avid a global financial collapse.

Barack Obama, New Deal Democrat or Pragmatic Progressive?
The ensuing Obama Administration stimulus package, the American Recovery and Reinvestment Act of 2009, focused on providing immediate relief to the banking and insurance industries and other entities but did little or nothing to restructure or relieve the mortgage debt burden on homeowners, farmers, and businesses. The results were that not only were the subprime mortgage borrowers losing their homes but so were the conventional borrowers who had responsibly acquired and serviced their debt. The reason for this was that the crisis caused a collapse in home values across the board.

As a result, a record number of American homeowners and farmers found themselves in foreclosure, pre-foreclosure, or serious arrears in 2008 and 2009. This far surpassed the number of property owners in that category during the Great Depression of the 1930s, when, far different from today's federal requirements, New Deal home loan policies and regulations placed the priority on bailing out the homeowner before the banker. President George W. Bush's Troubled Asset Relief Program (TARP) bailed out the banks because they were "too big to fail," and Barack Obama, to the surprise of many of his grassroots supporters, created policies that essentially mirrored the Bush "too big to fail" philosophy. Liberals expecting the "New, New Deal," as well as fiscal conservatives who feared that Obama would take on the dimensions of an “American Gorbachev” and restructure the entire economic landscape, were taken aback by the ease with which the Obama Administration fell in line with the Clinton and George W. Bush regulatory and economic policies.

Financial Industry Regulation Under President Obama

In July 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, which incorporated some of the most comprehensive financial and regulatory reforms since the New Deal. The Consumer Financial Protection Bureau, which was established under the new law, experienced significant delays in becoming fully operational. There has not been a single prosecution of any of the bankers, investment bankers, hedge fund operators, attorneys, or accountants responsible for the deliberate creation and distribution of the hybrid mortgage and securities that became known as the “subprime mortgage.” President Obama himself has taken the position that it would not be proper to prosecute individuals for exercising “bad business judgment.”

Bank of America, Countrywide, Citibank, and Wells Fargo, to name a few, have stonewalled Obama Administration programs that encourage loan modifications for affected borrowers, and the federal government has left itself without the enforcement tools needed to exact a reasonable quid pro quo from the banks to in turn bail out homeowners and farmers. In 2008 “private Investor” funds were encouraged by Treasury Secretary Timothy Geithner to participate in rehabilitating defaulted mortgage loans. Translated, that meant that in many cases “vulture funds” would buy defaulted paper at about seven cents on the dollar, feign attempts at loan restructure, foreclose on the homeowner, and warehouse millions of properties until the market came back 10 or more years later, and then sell them at a profit. The Standard and Poor’s 500 index was up 65 percent in President Obama’s first term in office, the largest gain for any first-term president since Dwight D. Eisenhower. Post-stimulus banker and CEO bonuses and compensation in 2009 exceeded even 2006 levels.

The president's historic health care reform law has begun to make badly needed changes in the area of national health care, and the administration's intervention in the automobile industry, while initially drawing great criticism, has in fact saved millions of jobs and repositioned American automakers to successfully recover and compete.

President Obama has yet to fully utilize the significant powers created under Dodd-Frank to break up or penalize any of the largest banks or investment houses. Sanctions directed against major financial institutions and CEOs have been limited to civil penalties and large fines.

Achieving the Balance—The “Real Deal”

In order to stabilize the national regulatory apparatus, the government must set a course that pursues core values in the form of clear, well-defined laws, rules, and regulations that are evenhandedly administered and enforced. Free market advocates must recognize that more is at stake than free market survival. Those who advocate government primacy in the role of ensuring integrity and transparency in the marketplace must accept the re-imposition of “standards, guidelines, and intelligible principles,” as well as fundamental fairness and uniformity in identifying, regulating, and prosecuting companies and individuals suspected of departing from norms of acceptable business behavior. Both the regulated and the regulator must be made to periodically account to Congress as to their respective roles in the process, and the predictability factor that is the mark of true due process must be ever-present.

Every possible defaulted residential and farm loan in the country must be modified so that homeownership can be once again stabilized. We must recognize that collectively the American homeowner and farmer are “too big to fail.” Banks should receive no further federal funds without an enforceable commitment to restructure defaulted loans, declare a moratorium on residential and farm foreclosures, and use the funds to lend to homeowners and businesses. Investors who purchase defaulted home debt instruments should be required to make every possible effort to restructure and modify homeowner debt so that the borrower can keep title and possession of the property in a comfortably sustainable manner.

Government must not be so aggressive or arbitrary in its application of legal and administrative enforcement policies as to dampen or even criminalize the American entrepreneurial spirit or to defeat economic growth.

Like F.D.R. we must strike the right balance and temper free enterprise with prescriptions for transparency, oversight, predictable accountability, and social responsibility.

Like F.D.R. we must use the laws and the economic and regulatory apparatus at our disposal to humanize and save capitalism.

We must look to the past and “learn backwards” to create a clear path to a future that entails competitive, fair, and just economic and regulatory policies as well as government regulation of business to maintain ethical, disciplined entrepreneurship and a participatory capitalism. These steps will go a long way toward bridging the great abyss between those with financial means in this country and those without.