

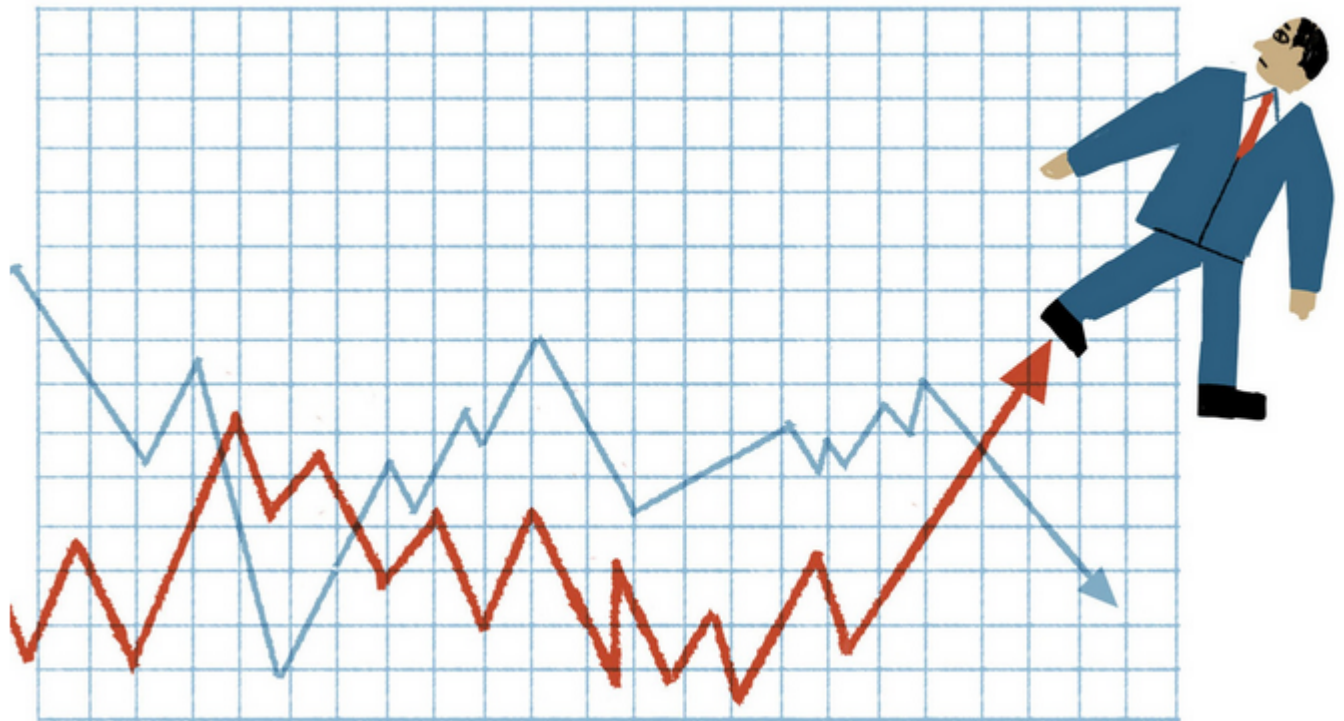
Inviting the Next Financial Crisis

It is infuriating that officials have put the welfare of most Americans at risk to enrich the wealthiest few.

By The Editorial Board

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The economy has come a long way from the dark days of 2008, when the collapse of Lehman Brothers and the bailout of big banks led to worldwide economic disaster. For much of the last decade, the economy has been growing and the stock market has been rising. But this steady climb is lulling bankers, lawmakers and regulators into repeating mistakes that contributed to that crisis and cost millions of people their jobs, homes and savings.

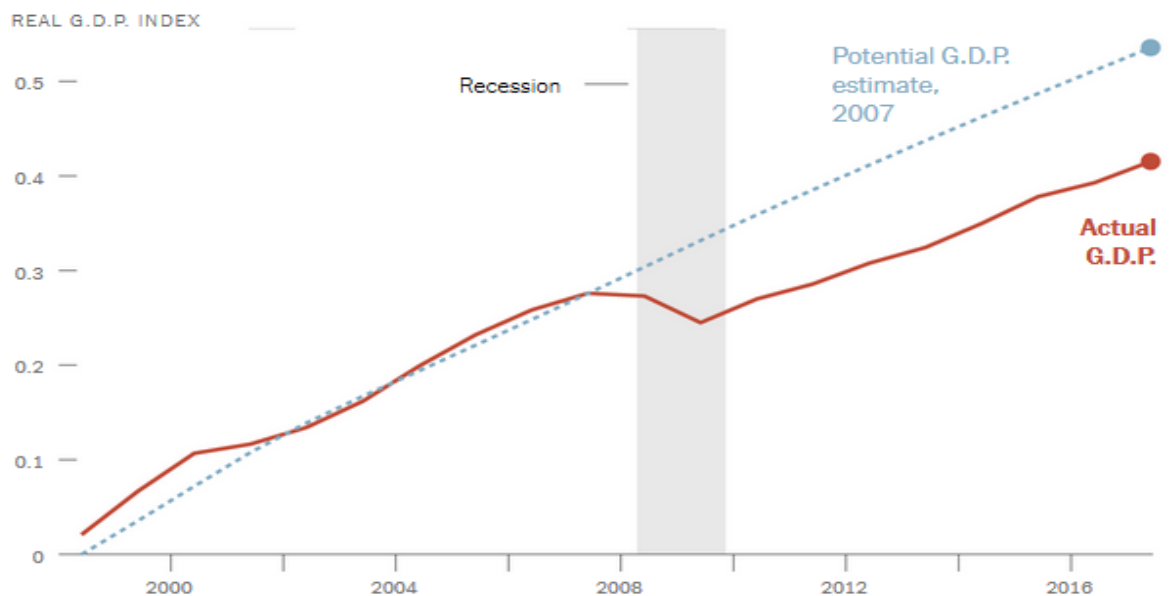
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The financial system and economy are clearly on much firmer ground than they were a decade ago. Wages are barely keeping up with inflation, but the unemployment rate, which climbed as high as 10 percent, has fallen to 3.9 percent. The housing market, once crippled by foreclosures, has sprung back to life, with home prices scaling new heights in many parts of the country. Banks, once dependent on taxpayer dollars to keep their doors open, are raking in profits.

Much of the credit for the recovery belongs to the swift response from the Obama administration, the Federal Reserve and Congress. Lawmakers and President Barack Obama worked to stimulate the economy by nearly \$1 trillion. The Fed pumped life into the financial system by lowering interest rates, buying bonds and rescuing institutions like the American International Group, which had insured financially compromised banks. Congress enacted the Dodd-Frank law, imposing tighter regulations on financial institutions and limiting their ability to take bet-the-farm risks with borrowed money. The law helped instill confidence in banks that had squandered their credibility by blowing billions on dubiously engineered investments that few understood and fewer could explain in plain English. It also created the Consumer Financial Protection Bureau, which defended consumers from predatory businesses. And Congress and Mr. Obama extended health insurance to 20 million people with the Affordable Care Act, protecting vulnerable families from crushing medical bills.

Yet the economy has still not fully recovered. The per capita gross domestic product of the United States is about \$70,000 smaller over the average person's lifetime than it would have been had the economy stayed on the trajectory it had been on before the crisis, according to a recent analysis published by the Federal Reserve Bank of San Francisco. The authors of that report — Regis Barnichon, Christian Matthes and Alexander Ziegenbein — conclude that the economy is “unlikely to regain” that lost ground, a stunning acknowledgment of the permanent and significant costs of avoidable financial crises.

The Recession Reduced G.D.P. – Perhaps Permanently



Notes: Scale is logarithmic to show comparable percentage changes. G.D.P. estimates from the Congressional Budget Office. Source: The Federal Reserve Bank of San Francisco

Of course, averages obscure a lot. Americans have not shared equally in the losses from the crisis. Families of modest means have far fewer, or in many cases zero, assets; they may have lost their homes and their savings. The average family of three earning less than \$42,500 a year saw its net worth chopped nearly in half, to \$10,800 in 2016, from \$18,500 in 2007, the Pew Research Center found. Wealth of families earning \$42,500 to \$127,600 fell by nearly a third, to \$110,100. Yet, the wealth of affluent families who earn more than \$127,600 jumped nearly 10 percent, to \$810,800.

The crisis and the government response to it worsened longer-term trends that have caused wages to stagnate for most families while rewarding the top 1 percent with an ever-bigger slice of the economic pie. Obama officials and Congress clearly made a big mistake early in the recession by focusing more intently on saving banks — and, thus, bankers and investors — and much less on directly helping families facing foreclosures and layoffs. Later in the recovery, the decision by Republican leaders in Congress to oppose every Obama proposal prevented the government from doing much to help people regain what they had lost or to heat up the tepid recovery with infrastructure spending and other stimulus measures.

Before the crisis, the share of economic output that went to workers had been falling steadily since early 2001, when it stood at 64 percent. After the crisis it plunged to about 56 percent, according to the Bureau of Labor Statistics, rising only slightly in the last few years.

This is because as workers' incomes have stalled, corporate profits have shot up, especially for a small number of what some experts call “superstar firms,” including technology giants like Apple; Alphabet, which owns Google; and Facebook.

As a few big companies with relatively few employees amass greater market power and profits, less is left over for workers, according to a 2017 working paper by economists from M.I.T., Harvard and the University of Zurich.

As a candidate, Donald Trump spoke about getting tough on Wall Street, fighting corporate consolidation and looking out for “forgotten men and women” — rhetoric that won him the support of some working-class voters who had backed Mr. Obama. But he and his fellow Republicans in Congress have governed like conventional far-right conservatives — going easy on Wall Street, doing little about corporate consolidation, bolstering corporate profits and gutting a range of protections for those “forgotten men and women.”

Last year, Republicans claimed their biggest legislative victory of the Trump era, reducing federal revenue by \$1.5 trillion over 10 years by slashing taxes on corporations and wealthy families. The legislation provides generous and permanent tax cuts to rich people in the investor class, including foreigners who own stock in American businesses. Working-class families, by contrast, received minor savings that are set to automatically vanish after 2025. The tax law will widen income inequality and encourage financial excesses by overstimulating an economy that is already nine years into a recovery.

Consider the stock market, which has shot up after the tax cut was enacted; the S.&P. 500 stock index closed at a new high on Friday. Many analysts argue that the market is not overvalued and has room to run — comments eerily similar to what Wall Street's salesmen were saying in 2007 and 2008. Yet, the market appears to be more overvalued now than it was before the crisis, according to an indicator created by Robert Shiller, the Yale economist who won a Nobel Prize for his work on bubbles in the stock and real estate markets. His data show that the S.&P. 500 stock index has an adjusted price-to-earnings ratio of 32.29, which indicates that investors are willing to pay \$32.29 for \$1 of corporate profits. In 2007 and 2008, that ratio never reached 28.

Lawmakers and the administration, and even the Federal Reserve, which should know better, are also sowing the seeds for another crisis by unraveling the financial regulations put in place in the last 10 years. In May, Congress voted to roll back parts of the Dodd-Frank law by exempting banks with assets of up to \$250 billion, up from \$50 billion, from stricter federal oversight. This was supposedly done to help smaller, community banks, but the change was so sweeping that it would leave fewer than 10 big banks under the kind of supervision many independent experts concluded was necessary after the crisis.

In addition, officials at the Fed and other government agencies have proposed relaxing the Volcker Rule, named for the former Fed chairman Paul Volcker, which restricts big banks from gambling with their depositors' money on high-risk investments. The regulators also want to ease capital requirements for banks, which will increase profits for the likes of Citigroup and JPMorgan Chase by letting them operate with more borrowed money rather than capital raised from shareholders. Last year, federal regulators decided that A.I.G. is no longer a systematically important financial institution, freeing it from the tighter government scrutiny applied to businesses whose collapse could set off a chain reaction of failures. While A.I.G. is smaller than it was in 2008, when it nearly toppled many big banks, it is still a very big domino in the financial system.

Wait, there's more. Mr. Trump has effectively neutered the Consumer Financial Protection Bureau by handing control of it temporarily to his budget chief, Mick Mulvaney, who has done the bidding of big banks as a bureaucrat and when he was a House member. He has stopped new investigations by the bureau and watered down penalties against lenders accused of preying on borrowers, to the point that the penalties are meaningless. Recently Mr. Trump appointed Kathy Kraninger, who has little experience in consumer finance, as the permanent head of the bureau.

The speed with which officials are moving to undo financial regulations is stunning to economists who remember their history. "The last time we regulated in the 1930s, it took us 30 or 40 years to take off those regulations," said Raghuram Rajan, an economist at the University of Chicago and former governor of the Reserve Bank of India. "This time we are doing it in 10 years."

And the regulations that were dismantled and eliminated could have helped prevent or reduce the severity of the last crash. Mr. Rajan, who was prescient in warning about the last crisis, said it's unwise to deregulate now because businesses and individuals have borrowed a lot of money in recent years in the United States and other countries, raising the risks of economic problems down the road.

With investors bidding up stock prices and pouring billions of dollars into money-losing start-ups as if nothing could go wrong, it is all the more frightening and infuriating that officials have so quickly tossed aside the lessons from the last crisis. In making life grander for the most comfortable Americans, the government is putting everyone's economic prospects at greater risk.