Financial fix: Time for better regulation

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Last month the U.S. Treasury Department gave vent to public outrage at the financial industry and ordered companies that were bailed out by government funds to reduce the basic salaries of their top 25 employees. The huge salaries and bonuses that are routine in the banking industry and on Wall Street are a ripe target at a time when the nation is still reeling from the near-collapse of the financial markets. The move by the Treasury Department was part of a larger effort by the Obama administration to regulate compensation throughout the financial industry, especially those pay schemes that encourage executives to take large financial risks for short-term gains.

Addressing compensation is largely symbolic, however. Though there is some satisfaction in cutting the financial titans down to size, populist outrage would be more fruitfully directed toward the work of regulating the banking and investment system to prevent another financial meltdown.

With the effects of the recession still grave—unemployment close to 10 percent and home foreclosures up almost 30 percent over last year—one would expect that the political will would exist to take on the Wall Street investment firms and the huge banks and ensure that unregulated derivative trading and greed do not again bring the nation to the brink of financial collapse. Unfortunately, it’s hard to focus public attention on the arcane world of hedge funds and investment bankers. That lack of focus leaves the task of reform in the hands of the politicians who sit on key congressional committees and who must withstand the formidable lobbying powers of Wall Street. It’s not reassuring to note that Obama’s own top financial advisers all come from Wall Street and are not likely to push their colleagues out of their comfort zones.

At the very least, reforms must be enacted that give government officials the authority to monitor and regulate capital investments and loan collateral so that banks don’t get to the point of being “too big to fail.” It’s also crucial to require transparency and standardization in the buying and selling of “credit swaps” and other derivatives, so that all players in the market know the risks they are taking.

In the 1930s, President Franklin Roosevelt enacted groundbreaking regulation of the banking and investment industry—regulation that helped maintain economic stability for 70 years. Since the 1930s, some of those regulations have been watered down, and new financial instruments have been created that have brought new uncertainties to the market. The shock of the Great Depression galvanized political leaders to act. They were convinced that a financial system so unstable as to plunge millions into economic despair had to be reformed. It’s time for this generation of leaders, having already saved the bankers from themselves, to show similar conviction.