

Proxmire's Forecast

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Alan Greenspan's confirmation hearing for Federal Reserve chairman was held in July 1987. Senator Proxmire from Wisconsin presided, as chairman of the Committee on Banking, Housing, and Urban Development. Unlike the future Federal Reserve chairman, it was the politician who foresaw the destructive power of banks.

The senator spent time reviewing Greenspan's "dismal forecasting record". Dismal as it was, Proxmire seemed more concerned about another topic: the concentration in banking. Greenspan testified during the great deregulation of banking. Initiatives included the emancipation of the savings and loan industry, authorisation for commercial banks to cross state lines, to offer home mortgages, to enter the brokerage business, to underwrite securities, and to change themselves into conglomerates offering all of the above services and more. The pressure to grow also pushed from the other end — investment banks that ran brokerages, brokerages that became investment banks, and so on.

Proxmire was concerned with Greenspan's lobbying efforts. Among other ventures, a top project was Sears' attempt to offer banking services. Proxmire addressed the candidate: "[Y]ou think, if we erected Chinese walls, you can still merge banking and commerce. And that shocks this Senator, and I think it should shock many others. You, in my judgment, favour an increased concentration of banking..."

(Aside from the larger issue, Proxmire had other concerns. In Greenspan's full disclosure of relationships before the hearing, he listed such directorships as Alcoa and J.P. Morgan. He did not include either Sears or Lincoln Savings & Loan. When questioned, Greenspan distinguished the two by calling them "advocacy projects". Cutting through the euphemism, he was paid by each to lobby for banking deregulation.)

Proxmire reminded the other senators that the Federal Reserve was acquiring greater control of the banking system: "[The] chairman of the Federal Reserve Board [is] the country's leading bank regulator. The Fed, as we know, regulates a large number of State member banks [and] bank holding companies that control an increasing proportion of all the commercial banking in our country. You take this position at a time when there's a headlong drive towards bank concentration."

Proxmire tutored Greenspan on the menace of financial concentration: "As chairman of the Federal Reserve you play the key role in approval or disapproval of these massive bank mergers... I would feel much better about this appointment if there was somewhere in your record an indication of your awareness of the dangers to our economy of excessive financial concentration. Maybe you can reassure us that you understand that banking should be separated from commerce and the unique multiplicity of banking in this country is an immense source of strength for our small businesses." The candidate was a director of J.P. Morgan and Company as well as its banking subsidiary Morgan Guaranty Trust Company. Large banks are generally indifferent to small business.

Proxmire also tutored Greenspan on the beauty of free markets: "[Y]ou can't have competition without having a large number of banks, as many banks as possible competing in every banking market. Do you have a conviction that regulators, no matter how able, cannot do the job as effectively and efficiently as competition? I hope as chairman you can show us this." This is a paradoxical situation of a politician lecturing the future Federal Reserve chairman that broad competition is preferable to government regulation of banking.

Proxmire's interrogation of Greenspan's conviction was

rhetorical. He described Greenspan elsewhere in the hearing as a "get along, go along" guy. Over the course of Greenspan's term at the Fed, banks merged and expanded until they were no longer banks. They take deposits, make loans, trade for their own accounts, manage hedge funds, serve as brokers for competing hedge funds, offer mortgages, securitise mortgages, sell securitised mortgages (e.g. CDOs, CBOs, CMBS), then sell credit derivatives to protect the buyer against bankruptcy of the securitised mortgage.

The Banking Committee chairman's statements and questions were directed to Greenspan, but he spoke with the frustration of a man who sees danger and found little acknowledgement among his fellow legislators. He seemed resigned to his lonely outpost: "It seems to me that banking in this country and finance in this country is likely to move very sharply ... in the direction of concentration... I think most senators, if they thought very long about it, might be very concerned too. And I think the American people would be concerned too."

The chairman concluded: "[T]his nomination should result in a slam-bang debate in committee and the floor. It won't, and it is startling, given what you have told us."

Senator Proxmire resigned from the Senate in 1989. Later that year, the Federal Reserve permitted J.P. Morgan to underwrite Xerox debt; the first such issue from a commercial bank since 1933, the year of the Glass-Steagall Act. That legislation separated commercial from investment banking. In what *Time* magazine called "the widest breach of Glass-Steagall yet", the Federal Reserve permitted J.P. Morgan to underwrite stock in 1990. Reading the 1987 transcript today, Congressmen would expand their understanding of how the financial system came to erode, rather than build, the American economy.