

Banking, Monetary Policy and the Political Economy of Financial Regulation

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Essays in the Tradition of Jane D'Arista

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1. Jane D’Arista: an appreciation

Tom Schlesinger

The papers in this book were originally presented at a conference in honor to Jane D’Arista in the spring of 2008 at the Political Economy Research Institute at the University of Massachusetts Amherst. Throughout her career as an author, analyst, congressional staff economist and teacher, Ms. D’Arista has brought together several strands of heterodox economics. While she may be characterized accurately as one of the last great institutionalists, her work also defies easy classification. Perhaps the clearest way to view Jane is as a tough-minded empiricist who has produced critical, original insights into the functioning of the financial system and economy – and done so with the uncompromising goal of improving human welfare.

Jane D’Arista followed a non-traditional and rather remarkable path to her place as a profound teacher, thinker and adviser on monetary and financial affairs. After graduating from Barnard College and beginning a family Jane took a position on the staff of the U.S. House Banking Committee in 1966. Under the chairmanship of Representatives Wright Patman and Henry Reuss (who replaced Patman in 1975) her responsibilities included the preparation of hearings, research and investigative projects. In this era, practitioners regarded the congressional research and oversight functions as serious obligations and the Banking Committee’s staff work routinely displayed a depth and rigor that would become virtually extinct in the Capitol Hill culture of more recent years. From 1975 to 1976 Jane served as a staff member and consultant on international banking to the Financial Institutions and the Nation’s Economy (FINE) Study, the first major examination of the financial system to assess the impact of American banks abroad and foreign banks in the U.S. (see “Foreign Bank Activities in the United States” and “U.S. Banks Abroad,” 1976).

The most noteworthy venture Jane undertook during this period was an account of the Federal Reserve’s first two decades of policymaking. Based on detailed archival records of the Fed’s deliberations and actions, *Federal Reserve Structure and the Development of Monetary Policy: 1915–1935* was

published by the Banking Committee in 1971 and painstakingly described the central bank's formative struggles over doctrine, policy goals and control of policy levers. Written in her "spare time" while juggling the demands of other staff work for the Committee and raising four young children, Jane's study blazed a trail for historical examination of the Fed through careful scrutiny of its internal records. Hailed by reviewers such as Anna Schwartz (*Journal of Economic Literature*, June 1995, 869–71) the study continues to be mined by scholars drawn to its insights into the external financial conditions, concealed in-house conflicts and competing modes of economic thought that helped shape the central bank's institutional development and policy innovations.

After serving on the Banking Committee staff for 12 years Jane moved to a senior position at the Congressional Budget Office where her analytical duties focused largely on international capital flows, foreign investment in the U.S., debt problems of developing countries and the recycling of OPEC (Organization of the Petroleum Exporting Countries) surpluses. In 1983 she was named chief finance economist for the House Energy and Commerce Committee's Subcommittee on Telecommunications, Consumer Protection and Finance. Three years later the subcommittee issued *Financial Restructuring: The Major Policy Issues*, Jane's comprehensive survey of changes in the U.S. and international financial markets. Her report presciently warned of the sector's growing instability and vulnerability to shocks. Subsequently, M.E. Sharpe republished the 1986 report and Jane's 1971 Federal Reserve history as a two-volume set, *The Evolution of U.S. Finance* (D'Arista, 1994a, 1994b)

After two decades on Capitol Hill, Jane D'Arista left Washington and co-founded the LL.M. Program in Banking and Financial Law at Boston University's Morin Center for Banking and Financial Law. Jane would remain at the Morin Center for 12 years following the untimely death of her husband, the painter Robert D'Arista. In addition to mentoring dozens of international students enrolled in the LL.M. program, Jane continued to engage in financial and monetary policy debates through her affiliation with the Economic Policy Institute and Political Economy Research Institute (PERI) as well as participation in an assortment of working groups and symposia.

In 1999, Jane became program director of the Financial Markets Center, a nonprofit research institute. Over the next seven years she authored quarterly assessments of domestic flow of funds data and international capital flows for the Center, identifying the unsustainable imbalances and the permissive, pro-cyclical policy regimes that led to successively larger and more disabling asset bubbles and crashes. Throughout this time Jane continued to find outlets for her love of teaching at the University of

Massachusetts Amherst, New School University and the University of Utah.

When the large-scale financial crisis Jane had long warned about erupted in 2008, the need for aggressive government action became unavoidable and the prospects for sweeping reform suddenly appeared to parallel the opportunities available to Franklin Roosevelt's New Deal. In this new circumstance Jane's insights provided a compass for policy change. In addition, Jane stepped forward to play a central role in organizing a broader set of intellectual resources to address the crisis and link those resources to reform-minded citizen groups. Early in 2009 she co-founded (with Gerald Epstein) a committee of economists and other analysts for Stable, Accountable, Fair and Efficient Financial Reform (SAFER). Along with Jennifer Taub, a law professor at the University of Vermont, SAFER worked closely with Americans for Financial Reform (AFR), a network of over 200 labor and community groups that struggled against the massively powerful financial lobby in an attempt to shape and support strong and effective financial regulation and reform in the wake of the Great Financial Crisis of 2008. Jane worked tirelessly to share her vast knowledge of the relevant financial issues, even as she never lost her critical perspectives on some of the weak and woefully inadequate rules that came out under the Dodd-Frank financial reform law. The period after the crisis of 2008 was a particularly rich period for Jane, as she wrote numerous papers, chapters for books, policy briefs for SAFER and other outlets, and gave a large number of radio and television, and video interviews, including on the Public Broadcasting System (PBS) and with the Real News Network. (See the abridged list of Jane D'Arista's "collected economics works" at the end of this chapter.)

During her decades of intellectual labor several overarching themes have distinguished Jane's research, writing and advocacy. These include her insistence on the primacy of the financial system's economic function, her perception that reckless market developments were undermining the sustainability of the U.S. and global financial systems (and with them the fate of the real economy), and her conviction that bold policy reforms were required to avert crisis, restore stability and systematically enhance equity.

By focusing on flow-of-funds trends, financial firms' balance sheets and other empirical observations – and by discounting the relevance of fashionably misleading creeds – Jane was able to see more clearly than most observers some of the central problems disfiguring the financial landscape over the past four decades (see *Flow of Funds Review and Analysis* and *Capital Flows Monitor, 1996–2006*). In her 1986 *Financial Restructuring* study she stressed that the channels for saving had changed radically since

the Great Depression – when the regulatory framework that was dismantled in the 1980s and 1990s had been created – and that nonbank financial intermediaries had become far more important elements in the financial system. New instruments that may have been unimaginable in the 1930s were now commonplace. Household savings that previously nested in insured depository institutions were now dispersed broadly as the liabilities of insurance companies, pension funds and other intermediaries in what would eventually be termed the “shadow banking sector,” carrying significantly more risk than would have been tolerated by the old regulatory regime. Indeed, in her seminal 1993 paper with Tom Schlesinger, Jane identified the dangers emanating from what they called the “parallel banking system,” long before others coined the term “shadow banking system,” which has now become so prominent in discussions of the great financial crisis of 2008 (see “The Parallel Banking System,” 1993). And Jane correctly anticipated that these risks could only compound as debt levels for households, businesses and the financial sector itself rose to unprecedented heights.

Jane was also critical of the so-called Washington Consensus and export-led growth policies the International Monetary Fund (IMF) prescribed for all developing and emerging economies after the financial crises of the 1980s and 1990s. She cautioned that these policies would have significant consequences in strong-currency countries other than the United States, which might not be willing or able to carry the current account deficits needed to ensure their success. In addition she argued that strategies of the large private financial institutions that dominate the international payments system intensified emerging economies’ vulnerability to financial crises. Financialization and liberalization increased exchange rate fluctuations and the exposure of developing countries to external shocks. Moreover, she noted, the risks inherent in the external accumulation of sovereign U.S. debt could have dire consequences for America, too, if a collapse in asset prices triggered the debt deflationary cycle of borrowers reducing their spending in order to deleverage and thereby further suppressing demand in a weakening economy. (See, for example, “Reforming the Privatized International Monetary and Financial Architecture,” 1999; “Replacing the Failed Washington Consensus,” 2009; “The Evolving International Monetary System,” 2009)

Despite the thrust (not to mention the accuracy) of her assessments, Jane has never succumbed to pessimism. Indeed, like John Maynard Keynes her work has demonstrated a singular flair for practical-minded prescriptions that would make markets work better for most citizens. When the vast majority of the economics profession and policy community enthusiastically promoted deregulation as a panacea for the financial sector, Jane

championed the idea of adapting the regulatory framework to evolving market practice by both enlarging and rationalizing the scope of government supervision and rulemaking (see “Rebuilding The Framework for Financial Regulation,” 2009) Likewise she has advocated the introduction of asset-based reserve requirements in order to shore up the diminished leverage of domestic monetary policy instruments in a financial economy that is no longer dominated by bank deposits.

Employing a similar analysis Jane also proposed the modernization of household savings guarantees. As she noted, deposit insurance was originally established during the Great Depression in order to prevent runs on banks (see “No More Bank Bailouts; A Proposal for Deposit Insurance Reform,” 1991). But as the financial system restructured during the final decades of the 20th century, the likelihood increased for equally destructive runs on insurance companies, mutual funds and other institutions that had become major administrators of families’ financial assets. Asserting that a new federal guarantee system should protect the core savings of ordinary Americans rather than the franchise of individual financial institutions, Jane offered a farsighted plan to mitigate household risk without engaging in the open-ended bailout of miscreant financial firms that has become a hallmark of U.S. public policy since the 1980s.

In addition, Jane has argued that credit allocation is a potentially useful instrument for environmental policy, and proposed the establishment of a U.S. Environmental Finance Authority, modeled on existing institutions that support home mortgage lending and designed to promote capital flows into endeavors advancing environmental goals (see “Where Credit is Due: Allocating Credit to Advance Environmental Goals,” 2002). At the same time she urged a fundamental redirection of international financial institution lending so as to support environmentally beneficial projects and policies in developing countries.

Jane’s work has extended across the globe. For example, she has proposed changes in the international financial architecture that would redress the chronic instability and structural inequities embedded in emerging economies’ dependence on exports for growth as well as the perversely recurring flow of capital from poor to rich countries. Jane’s proposal envisions closed-end mutual funds for emerging market investment – pools of patient capital managed by the public sector that would finance development strategies geared toward increasing domestic demand and raising incomes more equitably (see “Replacing the Failed Washington Consensus,” 2008). To deal with distortions perpetuated by the reigning privatized, dollar-based international monetary arrangements Jane also proposed the establishment of an International Clearing System. In the spirit of Keynes such a system would be coordinated by a global public

agency and enable cross-border monetary exchanges to take place in each country's own currency, thus allowing governments and central banks to conduct robust economic policies at a national level. In addition, the monetary reform would permit all countries to service external debt with wealth generated in their domestic markets and thus curb the unsustainable imperative for export-led growth. (In addition to the references above, see "Financial Regulation in a Liberalized Global Environment," 2002.)

In brief, Jane D'Arista's analysis has been prophetic and her ideas bold. Over time, her work has helped persuade numerous scholars and policy makers that another world was possible. And as anyone who has interacted with her directly can attest, this process of persuasion has been reinforced by Jane's uncommon warmth and generosity as well as an abidingly collegial spirit and democratic sensibility. The essays in this book reflect the various ways in which Jane D'Arista's thought was and remains influential. Her work and teaching has been a profound inspiration for students, colleagues and activists, and will continue to serve as a stepping stone for new thinking about monetary and financial policies for a more equitable and civilized society in the years to come.

APPENDIX: SELECTED WORKS OF JANE D'ARISTA

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