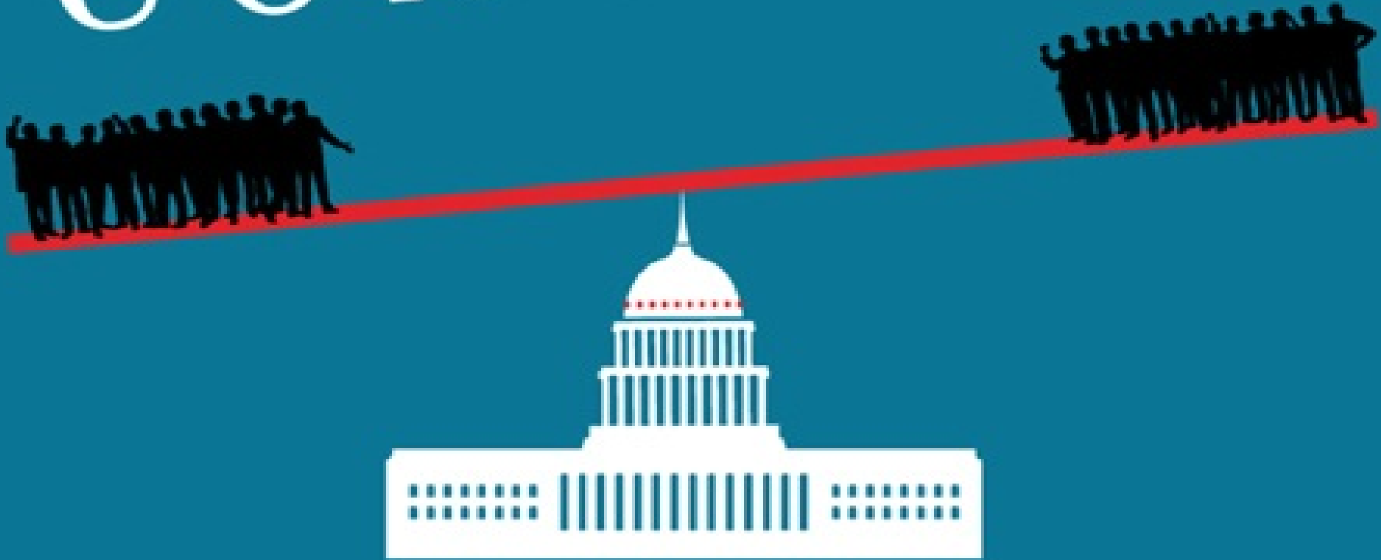
ACT of CONGRESS



HOW AMERICA'S ESSENTIAL INSTITUTION WORKS, AND HOW IT DOESN'T

Robert G. Kaiser

Act *of* Congress

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ALFRED A. KNOPF · NEW YORK · 2013

THIS IS A BORZOI BOOK

PUBLISHED BY ALFRED A. KNOPF

www.aaknopf.com

eBook ISBN: 978-0-307-96218-8
Hardcover ISBN: 978-0-307-70016-2

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Library of Congress Cataloging-in-Publication Data
Kaiser, Robert G., 1943–
Act of Congress : how America's essential institution works, and how it doesn't / Robert G. Kaiser.
p. cm.
Includes bibliographical references and index.
ISBN 978-0-307-70016-2
1. United States. Congress. 2. United States. Dodd-Frank Wall Street Reform and Consumer Protection Act. 3. Financial services industry—Law and legislation—United States. 4. Global Financial Crisis, 2008–2009. I. Title.
HG181.K35 2013
346.73′082—dc23
2012038245

Jacket design and illustration by The Heads of State

Manufactured in the United States of America

First Edition

v3.1

This book is for

Hannah Jopling

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Preface

Work on this book began in early December 2008 with an appointment in the cavernou office of Congressman Barney Frank of Massachusetts—Room 2252 of the Rayburn Hous Office Building on Independence Avenue in Washington, D.C., my hometown. I have a unlikely connection to the Rayburn Building, one that came to mind that day, my first visit several years. In the summer of 1960, just before I started college, I had a construction jo helping to lay the Rayburn Building's elaborate foundations.

Just a year later, after my freshman year, I was a delegate to the National Stude Congress in Madison, Wisconsin. One of the most formidable student politicians I met the was a Harvard delegate who talked too fast in a thick, New Yorkish accent, who ha mastered *Robert's Rules of Order*, who seemed to know everything about any topic that cam up, and who loved to make wisecracks. That was Barney Frank of Bayonne, New Jersey, the twenty-one years old.

I was just eighteen, but I already knew I wanted to be a reporter. I had spent the previou semester working on my college newspaper, where I discovered that this was the life for m Frank wanted to somehow participate in politics and public life. We both got what we hope for, and over the years our paths crossed from time to time. We maintained friend relations.

A few weeks before I visited him in Rayburn 2252, Frank and I had spoken on the phon about the Great Crash that had just shaken the foundations of the global economic system. A chairman of the House Financial Services Committee, Frank was more than a casual observe

"Your next book should be about this stuff," he had said on the phone. He knew that I ha recently finished a book on lobbying and money in Washington, but he didn't realize ho timely his suggestion was. At that moment I was eagerly looking for a new project, and th phone call got me thinking.

I did not want to write a book about the Great Crash, an event centered on Wall Street New York, beyond the world I know best. My subject is Washington and the politicians wh inhabit it. That phone call led to the thought that with cooperation from Frank and othe members, I might be able to write an interesting book based on Congress's response to th catastrophe. I had long thought Congress was America's least understood importa institution. I had been trying to figure it out for four decades. Maybe I could finally get to th bottom of its mysteries.

When I saw Frank in his office, I proposed that I become the historian of the congression response to the Great Crash, specifically of the effort I knew Frank and his Sena counterpart, Christopher Dodd of Connecticut, were planning—a new rulebook for America high finance. I'd heard Frank speak of "a new New Deal," a reference to the legislatio enacted in Franklin D. Roosevelt's first term that helped save American capitalism in th Great Depression. Frank's ambitions sounded big, even historic. And a new president share this goal, so it might actually be achieved. Would Frank talk to me as this story unfolde Would he allow his staff to tell me what was going on backstage? My ambition, I said, woul be to use the story of what he and Dodd did as a kind of case study that would explain th modern Congress.

Frank agreed. More important, he asked nothing in return—no assurances, no right to rea drafts of what I would write or to approve the way I used the material he provided. The ide that a reporter he knew would record his effort to make some history evidently appealed t him.

Next I needed to convince Dodd that he should help too. I had first met Dodd in the la 1970s, when he was a popular junior congressman from Connecticut. At the time I was *Th Washington Post*'s reporter in the Senate, so did not have a lot to do with the House. I got t know Dodd better in the early 1980s, when he became an active critic of the Ronald Reaga administration's Central American policy. We were just a year apart in age, and had bo grown up in the Washington area in the 1950s, when his father was a congressman an senator.

Dodd had given me a revealing interview for my book on lobbying. I realized then that h was an astute student of the Senate. I hoped he would see the merit of helping with th project. I confess it also occurred to me that he might feel a little competitive about Barne Frank, as House and Senate committee chairmen with overlapping jurisdiction tend to do, an would want to make sure that his side of the story was well covered in this book.

We first discussed all this in his "hideaway" in the Capitol, Room S-236. The room was pa of the original Capitol building, built between 1796 and 1800. Room S-236 was a fine spac about thirty feet by twenty feet with a high ceiling and a large window that looked we across the Mall toward the Washington Monument and Lincoln Memorial. There were sever dozen hideaways in the Capitol for senior senators (and none for members of the House); th was one of the finest, as befit a committee chairman with twenty-eight years of service in th Senate.

Dodd, in his own words, was "a believer in symbols." On this occasion he was eager t explain the oil portraits on his walls. "This is Samuel Morse," inventor of the telegraph. I 1844, Morse sent one of the earliest telegraph messages from this very room to a conventio in Baltimore, about thirty-five miles away. "That is the original senator from Connecticu Roger Sherman, the only one of the founders who signed the Articles of Confederation, th Declaration of Independence, the Constitution, and the Bill of Rights. And that one is Olive Ellsworth," coauthor of the Connecticut compromise at the Constitutional Convention th created the Senate as an upper house of the legislative branch. Dodd obviously loved th history, and loved the fact that he was a part of it.

He too agreed to be interviewed periodically, and to share information about h maneuverings as the story unfolded. Dodd was somewhat more circumspect than Frank; h wanted to be able to approve quotations attributed to him from our interviews. I agree hoping this would prove to be an insignificant condition. It did. Dodd never tried to withho or alter a quotation that I wanted to use in this book.

Both men also did something that proved critical to my research: They told their staffs th they could cooperate with me. In the modern Congress, staff members tend to disappear fro public view. Many talk to reporters, but usually anonymously, and nearly always with purpose: to advance the political interests of their bosses. Dodd and Frank gave me a unusual kind of access to the staffs of the Senate Banking and House Financial Servic committees, which vastly improved my ability to understand the legislative saga recounte here.

So I would have the chance to follow an important piece of legislation from fir conception to final passage through both houses of Congress—if Dodd and Frank could fulfi their shared ambition to pass a regulatory reform bill. I hoped that this story wou illuminate the culture of Congress, an institution that can appear mighty strange from afa but ought not seem foreign.

That was a lesson I had learned over nearly half a century of exposure to the House ar Senate. The Congress of the United States is a typically American institution. Its charter, th U.S. Constitution, is an inspirational document that persistently summons to service wh Abraham Lincoln called "the better angels of our nature." But—also typically—what th Constitution describes and what humankind creates are often just rough approximations o one another. From its inception in 1789, Congress has been razzed and ridiculed by skeptic citizens who, in a typically American way, expect the worst from their elected officials, ar get it just often enough to confirm their prejudices. Will Rogers, the early-twentieth-centur humorist, made a pretty good living ridiculing Congress with quips: "This country has com to feel the same when Congress is in session as when the baby gets hold of a hammer," fo example.

Also typically, though the founders expected that Congress would become the princip engine of American democracy and the venue for working out the country's most difficu problems, they provided few tools to assure this outcome. Instead they hoped and expecte that intelligent citizens would pay attention to Congress, run for Congress, and take Congre seriously. Many of the founders themselves decided to participate in the House and Senat suggesting that they anticipated similar interest on the part of future generations of th nation's best and brightest.

But, typically, those high-minded thoughts clashed with the cruder realities of a republ whose governmental institutions could make some men rich and others poor, could favor on section over another, could reward and punish for reasons that were decidedly not hig minded. Exchanges of favors and petty corruption became congressional reflexes, as did th flight from responsibility in the face of large national problems. In the modern age the tas that requires the most time and energy for a typical member of Congress is raising money t run for reelection. Legislative statesmen and -women are few. Occasionally a career Congress has appealed to the best and brightest citizens, but in our time that has not bee common. We may get a representative Congress, but we don't get a distinguished one.

By the early twenty-first century, Americans had lost touch with the institution in whic the founders had invested such hope. In surveys of civic knowledge, both the population large and America's students regularly embarrass themselves with their ignorance about the Congress. A *Newsweek* poll in 2011 found that less than 40 percent of Americans knew th term of office of a U.S. senator (six years). When the same question was posed to Arizon high school students, just 15 percent knew the right answer. How Congress does its man jobs remains a mystery to most Americans. This of course doesn't mean Americans can't judg the House and Senate. Voters hold overwhelmingly negative views of their Congress; i approval ratings in public opinion polls have been dreadful year after year.

Yet Congress has always attracted enthusiasts, people intrigued by the congressional circu and the individuals who perform in it. I am one of them. I grew up in a Washingto household consumed by politics (my father was a government official of modest importance and learned the basics at an early age. In my first job in journalism I was a copyboy for th Associated Press in the Press Gallery of the House of Representatives. That was in 196 when I was a nineteen-year-old college student. Whenever I could sneak away from the Pre Gallery at noon, I'd exploit my press credential to go down to the speaker's office on th second floor of the Capitol for his almost daily press conference. The speaker was John W McCormack, an Irish pol from Boston with a serious dandruff problem. McCormack favore dark, pin-striped suits that highlighted the dandruff. His noon press conference began with ceremonial brushing away of the flakes by William "Fishbait" Miller of Pascagoul Mississippi, a then famous congressional character who had the title of doorkeeper of th House of Representatives. When Miller had finished the cleanup, McCormack would answ reporters' questions, usually about pending House business, with a Boston accent thic enough to slice. The room was full of tobacco smoke, much of it from McCormack's cigar. found the spectacle irresistible.

A year later I went to work for *The Washington Post* and was further exposed to Congres one of the *Post*'s most important subjects. In 1967 *Esquire* magazine asked me to write profile of one of the most powerful members of Congress at the time, Wilbur Mills Kensett, Arkansas. Seven years later Mills became notorious for a drunken escapade with stripper named Fanne Foxe, a passenger in the congressman's car when it was stopped nea the Lincoln Memorial by a park policeman. Ms. Foxe tried to flee by splashing through th reflecting pool in front of the memorial. She and Mills were arrested. Mills eventuall admitted he was an alcoholic, a frailty I had missed.

The Mills I knew was the self-contained and self-controlled chairman of the most powerf committee in the House, Ways and Means, which is responsible for everything related to th raising of government revenue—taxes, and much else besides. When I trailed him around th Capitol, everyone he met greeted him as "Mister Chairman." At home in Kensett and Searc Arkansas, he was the fortunate son, a hero in his own time. He enjoyed strolling down Wilbu D. Mills Avenue in Kensett, a one- and two-story town fifty-five miles northeast of Litt Rock. Mills was small and mousy, which was deceptive, because he was so smart. H graduated second in his class from Hendrix College in Conway, Arkansas, then made the lea to Harvard Law School. He knew the tax code better than any other member of Congres And he had big political ambitions, which led him in 1972 to run for president.

It was a quickly forgotten candidacy with one enduring consequence. As a way to positio himself as a friend of the elderly on the eve of his presidential campaign, Mills sponsored change in the law providing for an annual cost-of-living adjustment in Social Securi benefits. Benefits have kept up with inflation ever since, preventing millions of senior citize from falling into poverty in their retirement years.

Chairmen of House committees can wield considerable power.

In 1977 I became the *Post*'s Senate correspondent, a job that gave me a wonderful educatio My most memorable experience was a trip to Louisiana in 1979 with Senator Russell B. Lon the son of Huey ("The Kingfish") Long, one of the most gifted American politicians of th New Deal era. Huey Long was a faker and demagogue but also a talented exploiter of th populist sentiments provoked by the Great Depression. He was a genuine radical who serve as governor of Louisiana and then as a senator for three years, until he was assassinated by relative of a political opponent in 1935. Russell was seventeen at the time.

When we traveled together in July 1979, Russell Long was chairman of the Senate Financ Committee, the Senate's equivalent of Ways and Means. He was famous for his brainpowe and his aphorisms. One of the best was his definition of tax reform: “Don't tax you, don't ta me, tax that fellow behind the tree!” I had covered Long extensively, but never had th chance to talk to him at length until that trip. We spent several days together—Long and and Henry Heltz, a retired Louisana policeman who drove the senator around the state in white Mercury sedan.

The high point of our travels was a visit to the town of Tioga in the center of the stat Tioga is home to the summer encampment of the United Pentecostal Church. Thousands o the faithful gather every summer in a giant tabernacle, the size of two football fields, tucke among groves of towering pines. They worship, sing, pray, often speaking in tongues, an listen to the exhortations of many preachers. The worshippers seemed intent on spiritu redemption, but Long's interest was political. These people vote as a bloc, he told me, an vote the way their leaders tell them to.

Soon after we had joined the throng, the Reverend T. F. Tenney, the church's leade announced that “the featured ones here tonight are Jesus Christ and then Russell Long Murmurs of approval followed.

Now it was Long's turn to speak from the pulpit: “Many of you knew my father. I've trie to follow along in his tradition. But I regret to say there's been a lot of mistakes made Washington.… Some of those decisions of that Supreme Court have been very misguide decisions. It leads me to wonder whether those justices start their sessions the way we do the United States Senate—with a prayer.” Now the murmurs became loud amens, punctuate with applause. “I want to make a little contribution,” Long continued, “so there won't be an doubt how I feel about the matter—the fine job you're doing here. It may not be much, b it's the largest contribution I've made at any one time.”

He handed a check to the bespectacled, round-cheeked Reverend Tenney, who wa obviously delighted. He held it up to the crowd. “I have a check here signed by Russell Long on the American Bank in Baton Rouge for $5,000,” he announced. The tabernacle fille with high-pitched groans of appreciation. “Praise the Lord!” Reverend Tenney said. The after a theatrical pause, he turned to Long and asked, “When are you running again Reverend Tenney led the crowd in laughter at his own joke. But it wasn't a joke. Long wou be on the ballot a year later. The last time he'd visited the tabernacle had been six yea earlier, a year before his previous campaign, in 1974. These Pentecostalists were his faithf supporters. He visited them as just another pandering politician.

And yet Russell Long was a serious legislator. He was notorious for the favors he did fo the oil and gas industries, both important to the Louisiana economy, but he was also th author and principal defender of the Earned Income Tax Credit, one of the government's lea appreciated and most important programs to help the working poor, supported by bo parties. Thanks to Long, low-income workers in the United States don't pay any income ta and can receive money back from the Treasury through this tax credit—today about $6,000 year for a family with three children. Benefits from the program add up to tens of billions year. Huey Long would have approved.

It was easy to poke fun at Russell Long, and at Wilbur Mills; easy too to be cynical abo their motives and behavior. But they taught a more complicated lesson: The same politicia can combine admirable qualities with dreadful ones, can demonstrate both pathetic huma frailty and a keen interest in helping ordinary people, sometimes courageously, in the cours of a career, or even the course of a week on Capitol Hill.

Congress is more than its colorful characters, who in fact have always represented a sma minority of the membership. Congress is a system and a culture. It is a wonderful laborator in which to pursue one of the reporter's favorite questions: How does it work?

I realized this during the biggest story I covered during my years assigned to the Senate- the ratification of the Panama Canal treaties. Now largely forgotten, for a few years in th 1970s there was no bigger political issue in America than the Panama Canal. The two treatie negotiated over six months in 1977, would slowly relinquish American control of the cana built by the United States in the early twentieth century, to Panama, while committin Panama to remain neutral forever and guarantee access to the canal to ships of all nations.

The treaties provoked sharp controversy. Conservative Republicans saw giving up the can as a sign of American weakness. Senator Jesse Helms of North Carolina and Ronald Reaga who first ran for president in 1976, were leaders of a popular movement to hold on to th canal, a symbol of Yankee imperialism throughout Latin America, but to those conservativ a proud American accomplishment and asset. Proponents of the treaties argued that the were a proper acknowledgment that the United States had no right to claim Panamania territory—which we had done, in effect, by ruling the Panama Canal Zone unilaterally fo seventy-five years. Returning the canal to Panama would help our diplomacy in Lat America, treaty supporters said, and put the United States on the right side of history.

Ratifying treaties, the founders decided long ago, requires two-thirds approval in th Senate—sixty-seven votes. The first head counts taken by Senate leaders early in 197 showed at least thirty strong no votes, and perhaps more. The outcome would be close.

The Senate debate on the treaties dragged on for two months. Many members behaved lik buffoons—no surprise, but startling to see at close range in such an important debate. Bu some also showed signs of nobility. The best, I thought, was Senator Howard Baker Tennessee, the Republican leader, who led a deeply divided Republican caucus. At least tw dozen of the thirty-eight Senate Republicans were die-hard opponents of ratification. Bak had presidential ambitions for 1980 and knew conservatives viewed him warily, b nevertheless decided to support the treaties, provided they were modified slightly. Thi Baker told me privately, was the right thing to do, though he knew it could cost him dearly the political arena. In fact it probably ended his career.

Sixty-eight senators—one more than needed—voted to ratify each of the two treaties. Ju enough members of both parties were afraid to take responsibility for sabotaging a trea that President Jimmy Carter and his senior diplomats said was of vital importance to th United States in its Latin American backyard. Courage—particularly Baker's courage—was necessary ingredient, but fear probably influenced more votes.

These stories and others like them had fed my fascination with the Congress, and taught m that on Capitol Hill reality was elusive. I hoped that this time, with the unusual access I ha been granted, I might finally get inside the legislative process and explain the reality—expla how the modern Congress works. I spent two years reporting this story, and conducte hundreds of interviews. Besides Dodd and Frank, a dozen key members of both houses, fro both parties, agreed to talk with me repeatedly while the legislation was pending.

Ultimately, Dodd and Frank were able to construct and pass one of the most ambitiou pieces of legislation that Congress has enacted in many years, a bill now named for both them—“Dodd-Frank.” But its final contents were uncertain for months, and important matte were resolved only in the wee hours of June 25, 2010, by the senators and House membe who took part in the special conference committee empowered to reconcile differenc between the similar bills passed earlier by House and Senate. Many years of experience ha not prepared me for the intricacy, the improvisations, the difficulty, or the drama involved passing this big bill.

Dodd-Frank is full of imperfections—“no bill is ever perfect,” as Senator Dodd put it. I principal authors revealed their own imperfections as they steered their versions regulatory reform toward final passage. Their huge “piece of legislation,” as new laws a called on Capitol Hill, will have unintended consequences—every big bill does. The effects many of its provisions won’t be known until regulatory agencies write and apply “rule under which they will enforce the law. Those rules will be challenged in court and altered practice. Eventually Dodd-Frank will be amended by additional legislation. Only the next b financial crisis will fully test the new law, if it remains in effect when that crisis arrives. Washington, nothing is forever, no argument is ever finally resolved.

This book is about the process that produced the bill. My hope is that these pages w explain the essence of a vitally important American institution.

Key Participants

Spencer Bachus, Republican of Alabama, the senior or "ranking" Republican on the House Financial Services Committe 2009–11.

Michael Barr, assistant secretary of the treasury for financial institutions.

Melissa Bean, Democrat of Illinois, active member of the House Financial Services Committee and of the New Democr Coalition of centrist Democrats.

Michael Beresik, Democratic staff member of the House Financial Services Committee.

Maria Cantwell, Democratic senator from Washington state.

Julie Chon, Democratic staff member of the Senate Banking Committee who made herself an expert on derivatives.

William Lacy Clay Jr., Democratic member of the House of Representatives from Missouri, whose father held the same se in Congress.

Rodgin Cohen, chairman of the New York law firm of Sullivan & Cromwell, one of the country's leading banking lawye and a Democrat.

Bob Corker, Republican member of the Senate Banking Committee from Tennessee.

Chris Dodd, Democratic senator from Connecticut and chairman of the Senate Banking Committee, 2007–11.

Anthony Dowd, former investment banker who served as an informal aide to Paul Volcker during negotiations wi Congress on financial regulatory reform.

William D. Duhnke III, minority (Republican) staff director of the Senate Banking Committee.

Diana Farrell, deputy director of the National Economic Council in the White House and one of the authors of the Obar administration's regulatory reform proposals.

Camden Fine, president of the Independent Community Bankers of America.

Barney Frank, Democratic congressman from Massachusetts and chairman of the House Financial Services Committee.

Amy Friend, chief counsel, Senate Banking Committee.

Courtney Geduldig, aide to Senator Bob Corker, Republican of Tennessee, specializing in Banking Committee issues.

Timothy Geithner, secretary of the treasury.

Gary Gensler, chairman of the Commodity Futures Trading Commission, one of the two principal regulators (with t Securities and Exchange Commission) of the exotic financial instruments called derivatives.

Andrew Green, aide to Senator Jeff Merkley, Democrat of Oregon, who worked on regulatory reform issues.

Judd Gregg, Republican senator from New Hampshire, who joined the Banking Committee in September 2009.

Jeb Hensarling, congressman from Texas, a leader of conservative Republicans on the House Financial Services Committee

Robert Holifield, staff director of the Senate Agriculture Committee, appointed to that job by Blanche Lincoln, Democrat Arkansas, when she became the committee's chairman in September 2009.

Steny Hoyer, Democratic congressman from Maryland and majority leader of the House of Representatives.

Paul Kanjorski, Democratic congressman from Pennsylvania, the second-ranking Democrat (after Barney Frank) on t House Financial Services Committee.

Larry Lavender, minority (Republican) staff director of the House Financial Services Committee and old friend of ranking Republican member, Spencer Bachus.

Carl Levin, Democratic senator from Michigan, chairman of the Permanent Investigations Subcommittee of the Sena Committee on Homeland Security and Governmental Affairs.

Blanche Lincoln, Democratic senator from Arkansas and, after September 2009, chairman of the Senate Agricultu Committee.

Frank Luntz, Republican pollster and political strategist, author of “The Language of Financial Reform,” a pamphlet offeri guidance to Republican members of Congress on how to effectively oppose financial regulatory reform.

Shawn Maher, Chris Dodd’s former staff director (2007–9) of the Senate Banking Committee, who became deputy director President Obama’s office of legislative affairs in 2009.

Patrick McCarty, staff aide working for Senator Blanche Lincoln and Robert Holifield on the Senate Agriculture Committe

Mitch McConnell, senator from Kentucky, Republican leader of the Senate.

Jeff Merkley, the junior senator from Oregon and a new Democratic member of the Senate Banking Committee.

Andrew Miller, staff aide to the Democratic majority on the House Financial Services Committee.

Jonathan Miller (no relation to Andrew Miller), staff aide to the Senate Banking Committee and Dodd’s advisor consumer issues.

Mark F. Oesterle, minority (Republican) counsel to the Senate Banking Committee, Senator Richard Shelby’s expert regulatory reform.

Nancy Pelosi, congresswoman from California and speaker of the house (2007–11).

Ed Perlmutter, Democratic congressman from Colorado, active member of the House Financial Services Committee.

Jack Reed, Democratic senator from Rhode Island, senior member of the Senate Banking Committee.

Harry Reid, Democratic senator from Nevada, majority leader of the Senate.

Jeanne Roslanowick, staff director of the House Financial Services Committee, Barney Frank’s most influential aide.

Jim Segel, special counsel to Barney Frank who handled political matters including cultivating the Democratic members the Financial Services Committee.

Richard Shelby, Republican senator from Alabama, the senior or “ranking” Republican on the Senate Banking Committee.

Ed Silverman, an old friend and former aide of Senator Dodd’s, who became staff director of the Senate Banking Committ in May 2009.

David Smith, chief economist, House Financial Services Committee. With Jeanne Roslanowick and Jim Segel, one of Barn Frank’s most influential aides.

Kara Stein, staff aide to Senator Jack Reed of Rhode Island, who worked with him on derivatives.

Nathan Steinwald, staff aide to Democratic senator Mark Warner of Virginia on Banking Committee issues.

Lawranne Stewart, counsel to the House Financial Services Committee and an important expert on Jeanne Roslanowic team.

Paul Volcker, former chairman of the Federal Reserve Board (1978–84), and proponent of new regulations to limit ban investments of their own capital. The Obama administration embraced this idea and called it the “Volcker rule.”

Elizabeth Warren, law professor at Harvard who first proposed creation of a new government agency to protect consume of financial products.

Mark Warner, Democratic senator from Virginia and member of the Senate Banking Committee.

MAXINE WATERS, Democratic congresswoman from California, senior member of the Black Caucus and of the House Financ
Services Committee.

MEL WATT, Democratic congressman from North Carolina, member of the House Financial Services Committee, and one
Barney Frank's favorite colleagues.

NEAL WOLIN, deputy secretary of the treasury.

EDWARD YINGLING, president of the American Bankers Association, who actively lobbied Congress against the consum
protection agency.

MARK ZANDI, independent economist and author of a book on the financial crisis admired by Republicans and Democra
Zandi's testimony in Congress was often influential.

Principal Organizations and Institutions

COMMODITY FUTURES TRADING COMMISSION (CFTC). Established by Congress in 1974, the CFTC is an independent feder agency whose purpose is to assure an open and honest market in the financial products variously known as swap futures, and derivatives. In 1998, with the support of the Clinton administration, Congress barred the CFTC from makin any new regulations of the booming market in "over-the-counter derivatives," often exotic swaps that became extreme popular with the mathematical wizards of Wall Street. The Dodd-Frank Act formally regulated this market and ga substantial new powers to the CFTC.

CONSUMER FINANCIAL PROTECTION BUREAU (CFPB). The new consumer protection agency established by the Dodd-Frank b with powers to regulate most American financial firms offering services and products to the public. The CFPB is a independent agency under the Federal Reserve Board, though the Fed cannot interfere with its operations.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC). The agency established by the Glass-Steagall Act of 1933 that insures t deposits in virtually every bank in the United States. The FDIC is a principal regulator of smaller banks that are n federally chartered, and of state-chartered savings banks. When a bank fails, the FDIC is responsible for winding up affairs and protecting the money of its depositors.

FEDERAL RESERVE BOARD (THE FED). The Federal Reserve is the central bank of the United States, whose prima responsibilities are to set interest rates, preserve the value of the dollar, stabilize prices, maximize employment, a regulate the nation's largest financial institutions. It is an independent agency run by a Board of Governors whose sev members are appointed by the president to fourteen-year terms. Its chairman—Ben Bernanke in the period covered by th book—is one of the most powerful figures in Washington.

HOUSE AND SENATE OFFICES OF THE LEGISLATIVE COUNSEL. Both houses of Congress maintain large staffs of lawyers a legislative experts whose job is to turn members' policy ideas into clear, concise, and legally effective legislative languag Both are nonpartisan offices that will draft a bill for any member or committee. House and Senate "Leg Counse (pronounced "ledge counsel") are among the most important and least publicized or understood institutions Washington. Without their expertise, the House and Senate would be unable to function as legislative bodies.

HOUSE COMMITTEE ON AGRICULTURE. One of the twenty standing committees of the House. All legislation affecting Americ agriculture must originate in this committee. It has jurisdiction over the Department of Agriculture and the Commodi Futures Trading Commission, which means it provides oversight of those agencies often by holding hearings on the activities.

HOUSE COMMITTEE ON FINANCIAL SERVICES. Another of the standing committees of the House, known until 2001 as the Bankin Committee. In the period covered by this book Barney Frank of Massachusetts was its chairman. The committe jurisdiction includes the federal laws and regulations governing the financial industry, housing, international econom organizations, bank and financial regulators, the Treasury Department, and the Federal Reserve.

HOUSE COMMITTEE ON RULES. The Rules Committee manages the flow of legislation to the floor of the House as an agent of t leadership of the party that controls the House of Representatives. In the modern era the membership has consisted of ni members of the majority party, and four members of the minority. The committee decides what bills will be voted on, wh amendments will be considered, and how much time will be allocated to debate amendments and the underlyi legislation.

HOUSE OF REPRESENTATIVES. The larger of the two branches of Congress, with 435 members, allocated to the states population. The seven states with the smallest populations each have just one member of the House; California, the bigge state, has fifty-three House seats. Members of the House serve two-year terms. Under Article I of the Constitution, t

House and Senate have equal legislative powers. For a legislative proposal to become law, it must be approved by bo bodies, and then signed by the president.

National Economic Council. A White House agency, created by Bill Clinton in 1993, intended to raise the profile economic policy issues inside the executive branch. The council develops policy ideas for the president and tries coordinate executive branch activities that affect the national economy. In the period covered by this book, the NEC w chaired by Lawrence Summers, the former treasury secretary and president of Harvard University.

Office of the Comptroller of the Currency (OCC). Oldest and biggest of the bank regulators, OCC was established Congress in 1863. It regulates all nationally chartered banks and savings banks. It is run by the comptroller, who appointed by the president and confirmed by the Senate to a five-year term. OCC is an independent unit within t Treasury Department.

Office of Thrift Supervision (OTS). A regulatory agency set up in 1989 to supervise the nation's federally and sta chartered savings banks, usually known as savings and loans or thrifts. OTS was established in reaction to the savings a loan scandals of the 1980s, but over time it developed a reputation as a lax regulator. Important institutions that regulated collapsed in the Great Crash, and it lost all support in Congress. The Dodd-Frank bill abolished it, giving responsibilities for regulating savings banks to the FDIC, OCC, and the Federal Reserve.

Securities and Exchange Commission (SEC). The SEC is the principal government regulator of stock markets. Established 1934 as part of the New Deal, the SEC regulates stock offerings and stockbrokers, and sets rules for the buying and selli of shares. The Dodd-Frank bill gave the SEC (with the CFTC) new regulatory authority in the derivatives markets.

Senate Committee on Agriculture. The Senate's version of the Agriculture Committee, with the same responsibilities as t House Committee. Senator Blanche Lincoln of Arkansas became the Agriculture Committee's chairman in September 200

Senate Committee on Banking, Housing and Urban Affairs. The Senate counterpart of the House Financial Servic Committee, which has essentially the same jurisdiction, and was primarily responsible for drafting financial regulato reform legislation. Chris Dodd of Connecticut was chairman of Banking in the period covered in this book.

Senate of the United States. The Senate consists of one hundred members, two from each of the fifty states. The foundi fathers created it to assuage the concerns of smaller states, particularly southern states, assuring them they would have loud voice in the affairs of the new nation. Senators serve six-year terms; one-third of Senate seats are contested elections every two years. The Senate has the same legislative powers as the House, plus several powers reserved for it the Constitution, including the confirmation of judges and executive branch appointees, and the ratification international treaties.

Treasury Department. The executive branch department responsible for managing the finances of the United Stat government, including collecting taxes, selling government bonds and notes, producing and managing coins and currenc paying the government's salaries and bills, and supervising and regulating national banks. The secretary of the treasury the president's senior advisor on all these matters and economic policy generally. Treasury and the National Econom Council shared responsibility for financial regulatory reform issues in the first Obama administration.

CHAPTER ONE

“I Could Hear Everyone Gulp”

Thursday, September 18, 2008, was a fine late-summer day in Washington—blue skie temperatures in the seventies. But the politicians on Capitol Hill were in no mood notice the weather. They were thoroughly distracted by chaos in the financial marke brought on by a series of seismic events: the nationalization of the government-supporte agencies that provided most of the financing for home mortgages, Fannie Mae and Fredd Mac; then the sudden death of one enormous Wall Street institution, Lehman Brothers; and unprecedented government bailout of another, the American International Group (AIG), huge insurance company that traded financial products too. The stock market was sufferin convulsions. The Dow Jones Industrials fell 504 points on Monday the 15th, the day Lehma Brothers went broke, then jumped 142 points on Tuesday, when the Federal Reserve Boar the American central bank, saved AIG, then dropped another 449 points on Wednesday, whe several huge financial institutions were teetering.

The United States Congress is normally immune to emotional reactions. It is a ponderou institution, usually cautious and always reactive. But some events break through th protective layers of ceremony and custom that typically insulate the House and Senate fro high emotion. One such event was unfolding in those September days.

“This is what a Category 4 financial crisis looks like,” members of Congress and othe Washingtonians read on the front page of their morning newspaper that Thursday. Steve Pearlstein, *The Washington Post*’s economics columnist, captured the sinking feeling th gripped the nation’s capital: “Giant blue-chip financial institutions swept away in a matter days. Banks refusing to lend to other banks.… Daily swings of three, four, five hundre points in the Dow Jones industrial average. What we are witnessing may be the greate destruction of financial wealth that the world has ever seen—paper losses measured in th trillions of dollars.… Finance is still a confidence game, and once the confidence goes, there no telling when the selling will stop.”

Open-ended bad news, a national and global disaster bound to get still worse—this was formula for unbridled fear among members of the House and Senate. They all knew that the would be blamed for whatever had gone wrong whenever angry voters got a chance register their reactions. The politicians always got blamed—this was an article of the professional faith. Fear of being blamed might be the single most potent motivator in th House and Senate. When Congress actually does something dramatic or unexpected, fear often the best explanation.

This financial crisis had undermined congressional confidence. In normal situatio members and especially senior leaders exude a sense of being on top of events, in contro This is an act, and often misleading, but rarely exposed. During this week in September, th actors stumbled. Congress was visibly on the defensive. Its pretentious facade crumbled. O the 16th, when leaders of the House and Senate met with Hank Paulson, the secretary of th treasury, and Ben Bernanke, chairman of the Fed, the fear was palpable.

That meeting was scheduled as Paulson and Bernanke were finalizing the plan for the Fe to put $85 billion into AIG, transforming the gigantic firm into a ward of the state. Paulso realized they needed to give key members of both houses advance warning for what wa about to happen. For decades, administrations of both parties had realized that Congre usually did not want to do much, but it always wanted to be consulted.

Paulson had arranged for such a consultation with Harry Reid, the Democratic senator fro Nevada who was the majority leader. They would meet at 6:30 p.m. in the conference roo of the Senate Rules Committee in the Capitol. The majority leader invited key senators an congressmen, including the chairmen of the two committees that had jurisdiction over th Fed, Senator Chris Dodd of Connecticut and Representative Barney Frank of Massachusett There were only a few chairs in the room, so all stood.

When Paulson and Bernanke explained what was going to happen, the room was hushe "There was an almost surreal quality to the meeting," Paulson later recounted. "The stunne lawmakers looked at us as if not quite believing what they were hearing."

Frank and Dodd both marveled that the Fed had the legal authority to simply make $8 billion available to AIG without anyone else's approval; theoretically these two men wer responsible for overseeing the Fed. That evening they discovered that the central bank ha powers they never knew existed. At the end of the meeting Senator Reid was blunt: "I wa to be absolutely clear that Congress has not given you formal approval to take action. This your responsibility and your decision." That was the true voice of Congress, covering its ow flanks before all else.

Now, on the 18th, Speaker Nancy Pelosi had gathered the leaders of her Democrat majority in her grand office on the second floor of the Capitol. On this day the stock marke had perked up, apparently encouraged by rumors that the administration was planning som new initiative to help banks cope with their suddenly rotten housing assets. We need to g Hank Paulson up here to talk with us, Pelosi told her inner circle. "I'll call him and set up meeting for tomorrow." After this meeting broke up, she put in a call to the treasur secretary. She wanted to be consulted.

For Paulson, a large, energetic man of high intellect, rich Wall Street experience, and n detectable political talent, this was another in a long string of very bad days. At nine th morning the vice chairman of Morgan Stanley had called to warn that his investment ban was teetering. The world's banks refused to lend money to one another—credit markets wer truly frozen. Disaster loomed. Paulson spent the next several hours exploring alternativ responses to the crisis with Treasury colleagues. He spoke to President George W. Bush o the phone and arranged a meeting with him for that afternoon to discuss what to do. In conference call with Bernanke and other Fed officials, everyone agreed that they would hav to make a formal request to Congress to appropriate hundreds of billions of dollars to sav the financial system.

No member of Congress was invited to join these conversations. This was typical o modern practice in a crisis: The executive would formulate a response, then bring it t Capitol Hill for approval. In this case, Paulson and Bernanke both realized how hard it wou be to get Congress to put up so much money to bail out banks.

Paulson was walking from the Treasury to the White House next door when he too Pelosi's call on his cell phone. She asked that he and Bernanke come up to Capitol Hill th next morning to brief the Democratic leadership.

"Madame Speaker," Pelosi recalled Paulson replying, "it cannot wait until tomorro morning. We have to come today." Paulson explained "just how bad things were" and said h would be asking Congress for emergency powers. "We need legislation passed quickly. W need to send a strong signal to the market now."

Paulson asked Pelosi to assemble a bipartisan group of senior members from both Hous and Senate to hear from him and Bernanke. Soon after this call ended, Bernanke and Paulso sat down in the Oval Office to explain the grim facts to President Bush: The administratio would have to ask for an emergency appropriation of half a trillion dollars to save th financial system and prevent another Great Depression. The dazed president approved th plan.

Pelosi conveyed Paulson's impatient message to her colleagues. They were taken abac Paulson wanted an urgent meeting with House and Senate leaders, but waited for Pelosi t call him before saying so? "He hadn't called us!" recalled Steny Hoyer, the number tw Democrat in the House of Representatives. Pelosi told Hoyer the meeting was set for 7 p.n Her staff invited the relevant members; Pelosi herself called Harry Reid, who invited the ke senators.

Thanks to a sense of grandeur that animated the many creators of the Capitol of the Unite States, members of the House of Representatives and the Senate work in extraordinar physical spaces. Some are ridiculously ornate, some feel like transplanted Greek temple some are quite beautiful. All convey a sense of importance—the sort of rooms that history made in. Members often volunteer the thought that the Capitol's splendor influences th attitudes of those who work in it.

Speaker Pelosi's conference room on the second floor of what is called the Capitol's we central front was a good example. It measures about fifteen feet by forty under vaulte ceilings decorated with classical designs and scenes from antiquity that look Roman. Orna gilded moldings separate the ceiling from the walls that Pelosi's decorator had painted in soothing coffee-with-cream tone. A beige carpet with a repeating diamond motif covered th marble floor. The room was dominated by a handsome mahogany table at least twenty-fiv feet long, big enough to accommodate twenty-two armchairs. Another thirty of the sam chairs lined the walls—seats for staff when large meetings were convened. Above the table giant crystal chandelier hung from the vaulted ceiling. Three windows looked west over th magnificent Mall; the view included the Washington Monument and Lincoln Memorial in th distance. There was just one piece of art on the walls, an oil portrait of Abraham Lincoln as young Illinois congressman, painted early last century—another reminder of the history mad in this building.

The meeting in the conference room on this evening was unusual in many ways, but provided a clear view of the congressional leadership reacting spontaneously to unexpecte bad news. Pelosi took her usual seat in the middle of the long table, with her back to th windows. Harry Reid sat on her right. The table was decorated with three bouquets of fres flowers and two bowls of nuts and chocolates—Ghirardelli chocolates from Pelosi hometown, San Francisco. The guests sat facing Pelosi and Reid: Bernanke, Paulson, sever of his aides, and Chris Cox, a former Republican congressman from California who was th hapless chairman of the Securities and Exchange Commission, theoretically the regulator many of the financial institutions now dead, dying, or endangered.

The others present were the two Republican leaders, Senator Mitch McConnell of Kentuck and Representative John Boehner of Ohio, who sat on Pelosi's left; Dodd and Frank and th senior Republican members of their committees, Senator Richard Shelby of Alabama an Representative Spencer Bachus, also of Alabama; and other members of the leadership o both houses: Democratic senators Dick Durbin of Illinois, Chuck Schumer of New York, an Patty Murray of Washington; Republican representative Roy Blunt of Missouri; an Democratic representatives Rahm Emanuel of Illinois and James Clyburn of South Carolin Pelosi had ordered that only a handful of staff be allowed into the room, and six or eigh were present.

Of this group, only half a dozen had a reasonably good understanding of the financi markets: Dodd and Frank, Shelby and Bachus, Schumer—an ardent supporter of h constituents—and Emanuel, a former investment banker. As Paulson had discovered in h two years in Washington, the gulf that divided Capitol Hill from Wall Street was wide an deep. Too many members of Congress neither understood finance, nor wanted to learn abo it. A prominent Republican in the House had confided to Paulson that "one third of our gu are real knuckle-draggers"—cavemen, primitives. After two years on the job, Paulson kne this to be true.

Pelosi quickly turned the meeting over to Paulson, who anticipated a hostile receptio when he asked members of Congress to approve hundreds of billions for the banks. The already suspected he was just trying to bail out his old friends on Wall Street, he had tol Bernanke at the White House that afternoon, after their meeting with Bush. "They'll kill m up there [on Capitol Hill]. I'll be hung out to dry."

Bernanke, an economics professor at Princeton before becoming a Federal Reserve Boar governor in 2002, volunteered to speak first to exploit his considerable credibility. He had n Wall Street experience; he was an academic, an egghead, whose specialty was the Gre Depression. He had the sort of rigorous, specialized expertise that can intimidate members o the House and Senate.

Paulson understood the mission. His chief of staff, Jim Wilkinson, a veteran of the Bus White House staff, had laid it out for him as he left the Treasury for Capitol Hill: "This only going to work if you scare the shit out of them." Paulson knew that Bernanke could d this best. So when Pelosi turned her meeting over to Paulson, he reported briefly on thei session with President Bush that afternoon and on the president's decision to propose ne legislation, then asked Bernanke to describe the state of the financial system.

Bernanke handled himself like a professor leading a seminar, but a seminar with an unusu subject: the possible end of the world as we know it. He assumed no prior knowledge on th part of his class. He explained: They were facing a grave financial crisis. There had been loss of confidence, and the markets were not working. There was a credit freeze. Th commercial paper markets had ceased to operate. The stock market had dropped by mor than a thousand points. The efforts he and Paulson had made to restore normalcy had prove inadequate, so they were now asking Congress to support an unprecedented appropriation o hundreds of billions of dollars to shore up the banks and head off total collapse. Bernank said that he had been studying the Great Depression for his entire adult life. "If we don't a in a very huge way, you can expect another Great Depression, and this is going to be worse he said sternly. "It is a matter of days before there is a meltdown in the global financi system." And he warned, "Our tools are not sufficient" to deal with this crisis.

"This is a save-your-country moment," said Cox of the SEC, implying that hundreds billions of dollars was a tolerable expense under such extreme circumstances. It's time come together and act, Cox said. He knew his former colleagues, knew that wrapping th cause in the flag could help.

Senator Reid noted that the stock market was up sharply that day, suggesting that mayb they didn't have to be so afraid. Bernanke dismissed this news—the market was up based rumors that this meeting was going to take place, and that new government action wou follow. If the expected actions didn't materialize, Bernanke said, the market would plummet

"I kind of scared them," Bernanke said later. "I kind of scared myself."

When Bernanke had finished his brief, terrifying lecture, Paulson spoke. In all his years Goldman Sachs (thirty-two of them until he became treasury secretary in 2006), "I've neve seen anything like this," Paulson said. They were living through a once-in-a-century event. T salvage the situation, "we have to buy residential and commercial mortgages and mortgag backed securities [from the banks that held them]. We need hundreds of billions of dollars start off." Congress, Paulson said, had to pass legislation at once—the next week—to allo Treasury to begin buying these toxic assets. Without action they faced a financial calamit The country could collapse.

In the words of Senator Dodd, there was "an eerie, jaw-dropping silence in the room." N one present had ever lived through a comparable moment. Now the usual, jaunty cockiness these men and women evaporated. "I could hear everyone gulp," said Senator Schume "People who talk for a living somehow couldn't think of anything to say," Dodd marveled.

Bernanke made another point based on his academic research: There are no examples history of a meltdown in the financial system that was not accompanied by a depression the rest of the economy. Main Street is tied to Wall Street. That is why the Congress neede to act quickly, he said—if it didn't act, a depression-type situation would result. Congre should pass a simple piece of legislation authorizing these purchases, Paulson said. He urge again that this be done quickly, without the issue becoming politicized.

"I chuckled when I heard that," said Jaime Lizarraga, a Pelosi aide who was in the roon and who knew from experience how politicized the House of Representatives had becom Partisan warfare had dominated Congress since the 1980s.

Members asked technical questions, many stemming from the fact that they didn't real understand what Paulson was proposing. The members knew they had a responsibility push Paulson for explanations, but they weren't always certain what to ask. How would th toxic assets be valued? Boehner wanted to know. We would pay more than their appare current value, Paulson said, hoping they would become more valuable over time. Who woul manage this process? Frank asked. Either the Treasury or a new entity to be created for th purpose, Paulson said. Wouldn't the announcement of this plan reassure markets and he restore some confidence? Dodd asked. Yes, said Paulson, an announcement of the plan shoul have "a salutary effect."

Senator Shelby was worried about the cost. Could it be as much as $500 billion? Ye Bernanke answered, it could be that much. The program should be "big enough to make difference," Paulson added, but said he didn't want to put a number on it now. Shelby, sittir next to his friend and colleague Dodd, who then chaired the Banking Committee they ha served on together for years, whispered into Dodd's ear: "Chris, they should have listened t you, they should have listened to you!" Dodd had been holding hearings on the frailties of th housing market for two years without persuading the administration or Bernanke that breakdown was at least possible and perhaps likely.

Congressman Frank, who by reputation possessed the quickest mind in the House Representatives, began to think ahead. They could do this, he said, but conditions had to b set. There had to be guidelines for the compensation received by executives of the firms th would be helped. Warrants were needed to protect taxpayers' interests—securities issued b the bailed-out firms that would allow the government to buy their shares at a fixed price, hopes that over time such warrants would become valuable, and help repay the governmen Practical ways had to be found to help more people avoid foreclosure, Frank insisted.

The idea of a government role in setting bankers' compensation alarmed Paulson. If yo insist on that, he said, the auctions could fail, because some banks and financial institution might refuse to take part in a program that threatened to limit their executives' pay. "If yo put in a compensation requirement," Paulson said, "I cannot say it [his auction scheme fo purchasing toxic assets] will work."

"If there are no compensation requirements," Frank snapped back, "I cannot say it wi pass" the House of Representatives.

And if a bill isn't passed? someone asked. "Heaven help us all," replied Paulson, practicing Christian Scientist. At this point, said one of the staff in the room, "the meetin was starting to get tense."

Spencer Bachus and his senior aide, Larry Lavender, a former Alabama businessman with glorious white handlebar mustache, had another idea. Instead of the complicated plan fo auctioning off toxic assets, why not just inject capital directly into the troubled banks b buying their shares? This had been done successfully in similar situations—in Sweden, fo example, in a banking crisis there in 1992. Ultimately Swedish taxpayers lost almost nothin because they owned a piece of their banks, which eventually returned to profitability. Bachu and Lavender had been discussing the possibility for months as they watched the America crisis unfold, and Bachus asked about it now.

Paulson shot it down dismissively. Simply buying shares would not have the positiv impact on the banks that was needed. "If you want something that will work," he said, "th [his plan] is it."

We need to leave this room saying that we're going to write a bill, Pelosi said, but he Senate counterpart, Harry Reid, was nervous about the timing: "If you think we can pass bill next week to give you $500 billion, you don't understand the Senate.... It takes me tw weeks to pass a bill to flush a toilet around here."

Mitch McConnell, the Republican leader in the Senate, demurred: "If what is at stake saving the country, we can do this in record time."

Schumer, the New York Democrat, said the administration had to offer somethin significant on foreclosures. Inevitably the Paulson plan would be seen as a bailout for th banks. Little people had to be seen to benefit as well as the big bankers. "We have to have foreclosure mitigation effort in order to pass this" in the Senate. "If we don't hel homeowners," Schumer added, "we will be damned."

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