

The Rise of Wealth Disparity in the United States and its Effects on Democracy: An Evaluation  
of the Great Recession and the Dodd-Frank Act

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## **Abstract**

This research paper attempts to provide insight on the significance of rising wealth disparity in the United States. Despite the global proliferation of social movements centered on inequality in 2012, wealth disparity remains a politicized issue and an in-depth, bi-partisan analysis of increasing wealth disparity is absent in American discourse. The Occupy movement's frame, "We are the 99%" begs the question: There will always be a bottom 99% and a top 1%, so what is the greater implication of increasing wealth disparity? During the 2008 financial crisis, as the amount of total wealth owned in the nation plummeted, wealth inequality increased at, debatably, the greatest rates seen in American history. An analysis of the financial crisis, rising wealth disparity, and the federal government's attempt to reconcile a financial market in collapse suggests that the American public lives within a cyclical system where the accumulation of wealth perpetuates the accumulation of political power at the expense society at large. Congress attempted to regulate the growing financial sector, which greatly contributed to the Great Recession and increasing disparity, by passing the Dodd-Frank Wall Street Reform and Consumer Protection Act. However, a financial elite and regulatory inefficiencies hinder comprehensive reform and regulation of the sector. Considering the causes for increasing wealth disparity, the American public and the American government have a vested interest to to strengthen democracy within the country by holding the financial sector accountable for its actions through increased regulation and enforcement of policies surrounding wealth disparity.

## **Acknowledgements**

I must admit that despite my attempt to provide an unbiased perspective, it should be taken into consideration that whatever research I am contributing on the topic of wealth disparity is strongly influenced by my politically liberal views and by the urban and environmental policy, economics, and sociology courses I have taken at Occidental College.

Thanks to everyone that has joined in my enthusiasm on this complex issues as I have worked on my senior comprehensive.

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## **I. Introduction**

Wealth disparity is a very complex topic that interweaves perceptions of human nature, economic growth, the role of government, and an individual's responsibility to the common good. Ideologies surrounding wealth disparity are highly contentious and are fundamental to perceptions that divide political, economic, and social justice theories. Despite the complexity of the issue, individuals in the media today frequently express narrow perspectives on increasing wealth disparity and coat their discourse around a political agenda.

The Occupy movement, which emerged in late 2011, unleashed a flurry of discussion around the issue of economic inequality in the United States to a magnitude that has not been seen in decades. Despite the Occupy movement's succinct, provocative, and encompassing frame, "We are the 99%," the movement is not founded on a wealth of popularly accepted knowledge or academic data and analysis of economic inequality is limited. Although, the Occupy movement re-introduced the American public to the fact that economic inequality in the United States is highly stratified, many in the nation were left apathetic to Occupiers plight. For, individuals generally don't care that athletes or Judge Judy make as much as \$30 million a year (Menon, Toronto Star, 2006). And much of the population has remained indifferent to the Occupy movement considering that since slavery was abolished, the wealthiest 1% have generally owned at least 20% of all wealth, many were not considered that today the richest 1% own 40% of American wealth (Interview, Shammass 2012; Sachs, Vanity Fair, 2012).

Research supports that Occupiers have a valid claim in that economic disparity, both income and wealth, is growing at unheard of rates. Since the 1980s, an increasing proportion of all income and all wealth in the nation has exceedingly flowed into the bank accounts of the United States' richest. This can be attributed to many factors including a steadily growing

financial market. The growth of the housing bubble, its subsequent burst, and the preceding Great Recession resulted in the further redistribution of proportional wealth in the hands of the United States' richest.

After participating in Occupy Los Angeles, I questioned the validity of the movement's frame since in capitalism there will naturally always be a 1% that will become richer over time. I sought to research the causes and implications of the recent surge in economic disparity to ultimately answer two questions. Why did the wealth gap increase after the financial crisis? And, does the government have a social-democratic responsibility to reconcile the growing wealth divide in the United States?

I use the financial crisis as a case study because it strongly correlates with the dramatic divergence of economic prosperity within the nation. Because of this correlation, my search to better understand the significance of growing wealth disparity ultimately brought me to an analysis of the financial sector and financial sector regulation since the financial sector and its lack of regulation played a pivotal role in the nation's economic collapse. Although both income and wealth disparity greatly increased during the late aughts, I chose to primarily focus on wealth disparity because wealth, more so than income, plays a critical role in determining social, political, and economic opportunities.

I answer my first research question by examining the correlations between increasing wealth disparity and the 2007-2009 financial crisis. There are multiple perceptions of who and what caused the Great Recession: federal homeownership policies, sub-prime mortgages issued by banks, irresponsible borrowers, the foreclosure crisis, and the trading of complex financial securities. However, all of these factors can be simplified to be understood as on-going trends that either lost wealth for some or increased the wealth of others.

To answer my second question, I analyze the federal government's relationship with the financial sector dating from the 1980s - when wealth disparity first started increasing. I evaluate the relationship between rising wealth disparity and the state of American democracy. Free-market ideology and the deregulation of the financial sector have been promoted by an increasing financial sector's grasp on politics via financial sector lobbying, campaign contributions, and a revolving door between financial industry and public office. A lack of financial oversight, potentially encouraged to increase banking profits, ultimately devastated the national and global economies.

In this way, the federal government has failed to provide crucial democratic services in that it favors financial interests instead of assuring the well-being of American tax payers. In an attempt to rectify an overly powerful and deregulated sector, the Obama administration and Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, the largest piece of financial overhaul legislation seen since the Great Depression. Despite the Dodd-Frank Act's tremendous ability to pinpoint regulatory flaws within the financial sector exposed by the financial crisis and its progressive trajectory in some fields, the process of writing, enacting, and enforcing much of the Act's policy demonstrates the continued clout of a financial elite. Catering to financial interests has been a constant theme in American political history since Reagan's presidency; and unfortunately, the introduction of the Dodd-Frank Wall Street Reform and Consumer Protection Act proves faulty as a financial sector 'fix' because of the magnitude of financial sector involvement in policy making.

Having said that, the interests of business and the elite have always been intertwined in politics, whether they be autocratic or democratic governments. Thus, I would be naïve to say that today our beloved democracy is now suddenly crumbling at the feet of financial rulers. I



assert that the government and the American people have a vested interest to strengthen democracy within the country by holding the financial sector accountable for its actions through increased regulation and enforcement of policies surrounding wealth disparity. There is a need to continue a dialogue regarding wealth disparity and the steps needed to diminish the growing divide as a bipartisan issue. The following is my attempt to participate in this discourse.

## **II. Methodology**

Through the process of this paper, I sought to find clarity regarding growing wealth disparity within the United States focusing on the growing divide of wealth that emerged from the financial crisis of 2008. I attempted to gain a balanced and comprehensive perspective on this hotly debated issue by conducting various forms of research. My primary data comes from 11 personal interviews and document analysis. My secondary sources are scholarly articles, news publications, and a documentary that I gained access to via the Internet.

By conducting interviews from a wide spectrum of backgrounds, I uncovered data on increasing wealth disparity, trends that contributed to increasing wealth disparity that were amplified by the Great Recession, and varying perspectives on the Dodd-Frank Act. I conducted 11 interviews: 2 academics, 7 employees at a Los Angeles bank, a representative of the organization Move to Amend, and a representative of the Party for Socialism and Liberty. A condensed list of the interview questions I used can be found in the Appendix.

I interviewed two academics to gain a historical and academic perspective of wealth disparity. Carole Shammas is an accomplished History scholar recently retired from USC who provided a historical perspective of wealth disparity within the United States. I also interviewed

Kirsten Wandschneider, a professor of economic history at Occidental College. She provided theoretical insight of various economic institutions that are at play today in the growth of wealth disparity.

I interviewed 7 employees at Wedbush Securities, a commercial and investment bank in Downtown Los Angeles. These interviews provided insight from across the political spectrum as well as the technical roadblocks associated with financial regulation.

I interviewed Edward Wedbush, the founder and President of Wedbush Securities. Wedbush built the largest stock brokerage firm in Los Angeles, which in 2010 managed more than \$15 billion in assets (Hamilton, Los Angeles Times, 2010). Our conversation skirted the subjects of wealth vs. income disparity and the role of CEOs in protecting their businesses as well as the overall economy. I also interviewed, Samantha McAfee the Capital Markets Business Conduct Manager at Wedbush Securities. In layman's terms, Samantha is in charge of evaluating financial regulations and making sure that Wedbush complies with them. She provided a liberal as well as practical perspective on financial regulation. Tom Murphy, an outspoken Libertarian, is the Managing Director of Derivatives at Wedbush Securities. He previously was a derivatives trader at Lehman Brothers. Mark Levy and Lawrence Manners are Wedbush's two Investment Managers. Levy in the 60's was a staunch Vietnam War dissenter and Manners in jest left me a note that read 'Greed is Good'. Two employees wished to remain anonymous. One is an executive vice president at Wedbush and the other a Chartered Financial Analyst. One of my interviews at Wedbush Securities only semi-counts as an interview. I interviewed my father, Tom Eilers, who is a proprietary trader at Wedbush. Thanks to my senior thesis on wealth disparity I now understand how my father earned his money to be able to send me to Occidental

College. If it were not for growing wealth (and subsequently growing wealth disparity) I most likely would not have had the opportunity to write this paper.

I also spoke with two individuals from the far left. I interviewed the head of Move to Amend Los Angeles, Daniel Lee, before an Occupy Los Angeles General Assembly in Pershing Square in Downtown Los Angeles. Move to Amend is a coalition in response to the U.S. Supreme Court's ruling in Citizens United that aims to amend the United States Constitution "to firmly establish that money is not speech, and that human beings, not corporations, are persons entitled to constitutional rights" (Move to Amend, 2012). I also interviewed a representative of the Party for Socialism and Liberty, Francis Gillerlain. Francis and I spoke largely about the foreclosure crisis and the theoretical aspects of wealth disparity.

I further gathered primary research through document analysis of the Dodd-Frank Act. To fill in the gaps and to conduct background research, I turned to secondary sources from news publications, scholarly articles. I primarily relied on Bloomberg and the New York Times. I also watched the documentary "Inside Job" for better insight on the financial crisis. I further gained all other background information needed to have a foundation for my research from talk radio and Wikipedia.

### **III. Background**

#### **A History of Economic Disparity in the United States from the 1800s to the Present**

For centuries, there have been waves of movements in which the effects of economic disparity were at the forefront of popular consciousness, and generally accompanied with a passionately discontented lower-middle class. This can be seen in the French Revolution, the

People's Revolution of the Philippines, the recent European anti-austerity protests, the on-going Arab Spring, and the Occupy movement. Popular uprisings have frequently gone hand-in-hand with concern surrounding business-government relations and how, in turn, this relationship threatens democracy. However, in the past, as today, businesses lying in bed with politicians is only a part, albeit a major part, of growing wealth disparity in the country.

Beginning in the Gilded Age of the late 1800s, labor unions and politicians vocalized their discontentment about the distribution of wealth. Although corporate businesses were extremely lucrative and the nation's GDP grew exponentially during the Gilded Age, labor unions claimed that corporations exploited their labor by maintaining low stagnant wages and political players decried government-business relations as corrupt (Mintz, 2007). During the Gilded Age, dissenters of growing wealth disparity couldn't even say "we are the 99%" because it's very likely that business tycoon, Rockefeller, alone owned more than 1% of total wealth in the country. Rockefeller's worth was 1/65 of the entire nation's GDP (Fortune, 2012). A growing awareness of the economic injustices during the Gilded Age inspired the growth of the Progressive Era (1890-1910). The Progressive movement sought to decrease the economic gap in the country and increase democratic practices. Invaluable legislation passed to decrease the economic gap within the country. Take for example, the Sixteenth Amendment, which implemented an income tax, and the Seventeenth Amendment, which took the power of electing State Senators from businessmen and gave it to the people (Mintz, 2007). Despite the Progressive Movement's successful attempt to limit business interests in politics government involvement in the economy, regulate businesses, and diminish the economic gap in the country, the nation continued along the same trajectory as before: a nation of the rich for the rich. In 1922, the richest 1% of the country controlled over 37% of the nation's wealth (Domhoff, 2012).

Then, the Great Depression of 1929 hit. The nation was plagued by its worst economic crisis and ironically the very same forces that drove economic inequality. Powerful individuals and businesses held a tight grip on politicians, policy-making, and the economy. During the 1920s, financial regulation was nonexistent. Interest rates were lowered, rates of borrowing rose, and Americans bought housing and financial assets on credit. These factors contributed to a housing boom in the country. Meanwhile, brokerage firms riskily lent up to 90% of the value of their assets. (Does any of this sound familiar?) In addition to an already growing divide, the United States' most devastating Stock Market Crash of 1929 resulted in a further growth in wealth disparity that persisted for a 10-year long Great Depression (Krafts and Fearon, Oxford, 2010).

Although, today wealth inequality is dramatically lower than the rates seen before the Great Depression, wealth disparity has persisted since the 1920s, fluctuating as a response to government legislation, the financial sector, and economic growth. However, there has been minimal public comment about wealth disparity since the Great Depression. In an interview with a former history professor from USC, Shamas, explained that since the 1930s the topic of wealth disparity has fallen out of the public's mind except for the occasional attention brought from labor unions, Communists, and Socialists (Interview, Shamas, 2012).

Today the topic of wealth disparity has resurfaced once more in the media and in American conversations after a hiatus of over 70 years. The Occupy movement started in New York City in September of 2011 and has a message central to economic inequality: "We are the bottom 99%". This message refers to the large and increasing portion of American wealth that is concentrated in the hands of the country's richest 1%. Apart from being a response to rising economic disparity, the movement is also a response to a lack of government ability to right the

wrongs that caused the Great Recession. The movement is largely comprised of angry individuals that believe greed within the financial sector has harmed the American people and American democracy for the sake of making a profit. Occupiers say that it is unfair that, after financial institutions knowingly gave out unstable mortgages and later bundled them into risky securities, the country's "bottom 99%" continue to suffer from the consequences of the recession while bank CEO's receive bonuses. Americans bonded over a shared grievance of economic injustice and the Occupy movement garnered enough support to conduct encampments in 45 states, in over 70 of the nation's largest cities, and 600 of its smaller communities (Walters, 2011). A list of Occupy Wall Street's demands can be seen in the Appendix.

### **Wealth Disparity as a Subset of Economic Disparity**

Economic inequality exists in two forms: as income and as wealth inequality. Although frequently used synonymously, correlation between wealth and income disparity is limited. This paper continues to specifically highlight wealth disparity as a subset of economic disparity. In this section, I argue that wealth is more indicative of an individual's well-being and source of opportunity than income.

A household's income is the amount of money received in a paycheck as part of a salary. Income also includes what people earn from dividends, interest, and royalties paid to them, such as a landlord's income from rental properties (Domhoff, 2012). Income, when not used and put into a private savings account, becomes wealth. However, wealth is more than just accumulated, un-spent income. Wealth is defined as total assets minus total liabilities. Assets are the individuals' or households' economic resources that are owned but may change in value over time. There are two types of wealth: non-financial assets, such as real estate, and financial assets,

such as stock holdings and retirement funds. Liabilities include mortgages, credit card debt, outstanding medical bills, and student loans (Allegretto, 2011, 2).

I contend that wealth disparity is a better tool for measuring economic inequality within the United States because social mobility is a pillar to the realization of the ‘American Dream’ and the procurement of wealth is an intrinsic factor to actualizing social mobility. For example, the new opportunities offered as a result of increased education or moving to a new neighborhood rely not on just one’s paycheck, but money saved over time – in other words, their wealth. The accumulation of wealth within checking and savings accounts will later determine a household’s ability to invest in education, training, business, or retirement funds, as well as, tangible wealth such as cars, computers, and homes. Not only is owning wealth crucial to social mobility, but a lack of wealth can directly affect one’s ability to fully participate in work, school, and community (Allegretto, 2011).

Moreover, wealth is distinguished from income in that wealth is more indicative of personal well-being and opportunity than income. Previous research demonstrates that wealth has been found to have a more dramatic impact on American lives than income. For example, wealth is used as a safety net and is relied on for the realization of new opportunities. Wealth functions as a buffer against income loss or financial emergencies that may result from unemployment or illness. The household will need to dip into its wealth by either taking money from its savings or liquidating its assets. Similarly, the state of poverty from a lack of income may be short-lived, but poverty due to a lack of wealth persists over a long period of time (Mueller, 2011). This is one of the reasons why the foreclosure crisis was so devastating: its stripped many Americans of their most valuable asset.

Edward Wolff of Bard College, a predominant scholar in the field of wealth disparity, agrees that wealth has a greater significance on American well-being than income. He conducted studies that demonstrate wealth effects household behavior more than income and that “in a representative democracy, the distribution of power is often related to the distribution of wealth” (2010, 3). Thus, wealth is a source of power in a representative democracy. Historically speaking, the Great Recession amplified and exposed trends specific to wealth disparity. Today, an increase in wealth can be synonymous with an increase in political power. Understanding the difference between income disparity and wealth disparity is crucial to understanding how policies should address the rising wealth disparity gap.

It is pivotal that policies that intend to specifically tackle wealth disparity do so; for, a reduction in income inequality does not necessarily mean a reduction in wealth inequality. Scandinavian countries are praised for their progressive redistributive income taxes, and are happier global citizens for it; however, Sweden and Denmark have some of the greatest levels of wealth inequality in the European Union (Wilkinson, 2009) (Mueller, 2011). The Netherlands has the most wealth inequality of the countries studied in the European Union. Conversely, countries like Greece and Italy, which have much higher rates of income disparity, have minimal rates of wealth disparity (Mueller, 2011).<sup>1</sup> Therefore, the social-democratic governments seen today that employ redistributive income taxes and strong welfare programs are not as effective in minimizing the wealth gap as opposed to the income gap. Table 1 in the Appendix demonstrates some of the findings of the study I am referring to.

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<sup>1</sup> This study was based on data collected about income and wealth disparity among senior citizens in thirteen European Union countries in 2006 and 2007. The authors’ believe their findings to be representative



## **The Wealth Gap**

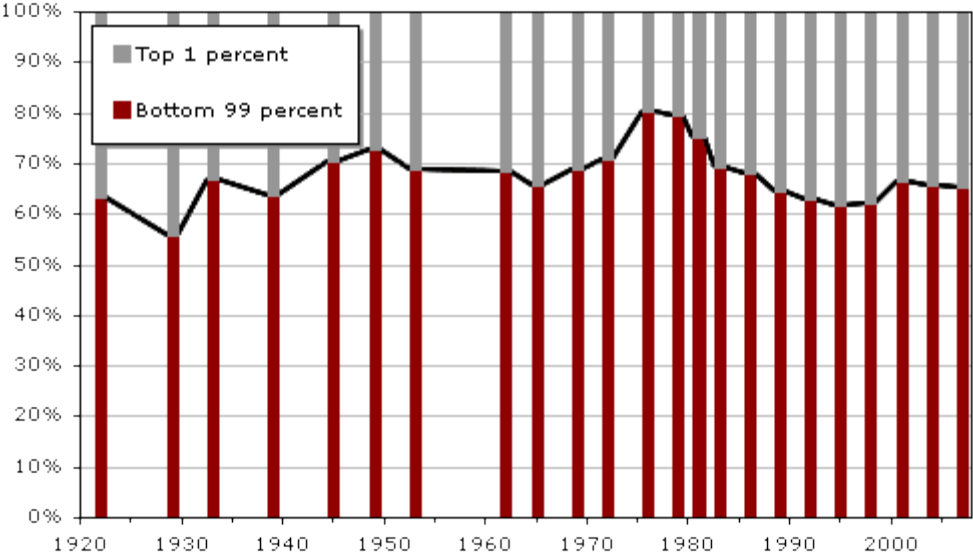
Wealth and income disparity are both rapidly increasing in the United States, but wealth inequality is more disparate than income inequality. Further, financial wealth inequality is the most stratified form of economic inequality in the United States (Allegretto, 2011). The 2008 financial crisis further stratified wealth in the nation.

Wealth disparity is measured by comparing the proportional amount of wealth owned by different socio-economic classes within the country and treats disparity as a zero-sum game. Generally, data is categorized by quintiles. However, in the spirit of Occupy, the majority of the data that I present looks at the wealth owned by richest 1% and poorest 99% as a proportion of total household wealth owned in the United States.

The following data was gathered from Professor Domhoff of UC Santa Cruz based on Edward Wolff's most recent paper on wealth disparity. Below, Figure 1 and Tables 1 and 2 depict the changing distribution of wealth in the United States. Figure 1 tracks wealth disparity from 1922 to 2007. It is evident that wealth disparity was at its greatest in 1929, right before the Great Depression. This can be attributed to the burst of a housing bubble, high amounts of debt, and plummeting stock values. Wealth disparity decreased in the 1930s and 1940s due to low unemployment rates, high saving rates, and the implementation of progressive tax policies. During the 1930s, Roosevelt introduced the Social Security Act as part of the New Deal and in the 1940s World War II and income tax reform also decreased economic disparity (Domhoff, 2012). Again, in the early 1970s, disparity began to diminish. Domhoff attributes this to a fall in stock prices, which means decreased wealth for the rich, since the rich are most likely to own stocks. During the 1980s the gap began to grow again and in the late 1980s inequality was almost as disparate as right before the Great Depression. This can be attributed to a growing financial

market, lowering tax rates, declining union power, an increasing gap in CEO and worker compensation rates, and a loss of domestic jobs due to outsourcing. Lowering stock values due to the dot-com bubble burst of 2001 also slightly decreased wealth inequality.

**Figure 1 Distribution of Wealth (1% vs. 99%) in the United States from 1922-2007**



Source: Domhoff, 2012

The following two tables quantify changes in wealth disparity in the United States from 1983 to 2007. Although this data is similar to the data presented in the previous graph, it provides a more in-depth look at recent years by its breakdown of wealth owned by the richest 1%, the rest of the richest quintile (the next 19%), and the bottom 80%. For example, in 2007 the richest 1% controlled 34.6% of the nation’s wealth, but the nation’s richest 20% (the top quintile) owned 85.1% of all wealth while the rest of nation’s households controlled only 15%.

The data suggests that wealth disparity rates have been fairly consistent since the 1980s. Note later the surge in wealth disparity due to the 2008 financial crisis.

**Table 1 Distribution of Total Net Worth (in %)**

	<u>Top 1%</u>	<u>Next 19%</u>	<u>Bottom 80%</u>
1983	33.8	47.5	18.7
1989	37.4	46.2	16.5
1992	37.2	46.6	16.2
1995	38.5	45.4	16.1
1998	38.1	45.3	16.6
2001	33.4	51	15.6
2004	34.3	50.3	15.3
2007	34.6	50.5	15

Source: Domhoff, 2012

As exemplified by the following table, financial wealth is dramatically more disparate between the rich and the rest of the population than just total wealth. In 2007, the richest 1% owned 42.7% of the nation's financial wealth, the richest 20% owned 93% of financial wealth, while the bottom 4 quintiles owned 7.5% of all American financial wealth. Over the past decades, the richest 19% have roughly controlled the same amount of total wealth as financial wealth. The difference between the above and below tables is that what the bottom 80% lacks in financial wealth in comparison to what they control in national total wealth, the top 1% gains. The wealthy are most likely to own financial assets. 95% of households that earn more than \$250,000 a year in income own stocks and collectively own 53.7% of all stock issues (Allegretto, 2011). This can be attributed to the specific educational and cultural stipulations of investing, limiting financial markets to the realm of an elite.

**Table 2 Distribution of Financial Wealth (in %)**

	<u>Top 1%</u>	<u>Next 19%</u>	<u>Bottom 80%</u>
1983	42.9	48.4	8.7
1989	46.9	46.5	6.6
1992	45.6	46.7	7.7
1995	47.2	45.9	7
1998	47.3	43.6	9.1
2001	39.7	51.5	8.7
2004	42.2	50.3	7.5
2007	42.7	50.3	7

Source: Domhoff, 2012

When the economy does well, wealth has consistently been further concentrated in the hands of the rich. Analysis of the economy's peak years of 1989, 2001, and 2007, demonstrate that when business cycles reach a peak, the nation's total pie of wealth gets re-divided in favor of the richest quintile, at the expense of the bottom quintiles. For example, while the nation's economy expanded from 2001 to 2007, the amount of wealth in the top quintile grew by .6% at the expense of a .6% loss in the bottom 80%'s wealth (Allegretto, 2011).

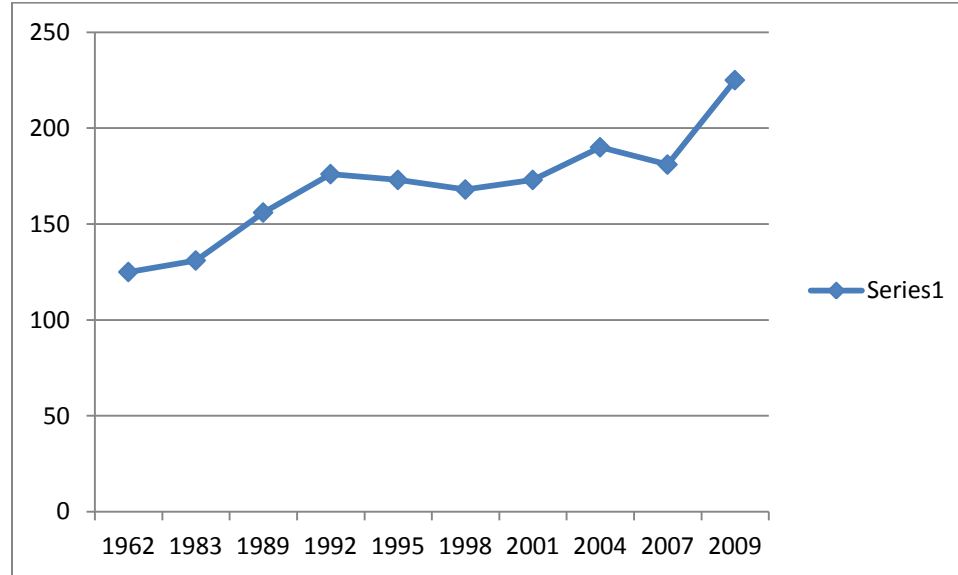
The nation's wealthiest reaped the benefits of the nation's booming years during the aughts, and also gained proportionately more wealth after the collapse of the housing bubble. During the Great Recession, of 2007 to 2009, 2.2% of the nation's total wealth shifted from the bottom 80% and ended in the bank accounts of top 20% (Allegretto, 5). This can be seen not purely in that the rich became richer, but because many Americans became worthless. As households were foreclosed on and the value of stocks dropped, many Americans sank into states of zero or negative worth. In 2009, 24.8% of American households either held no wealth or were

in debt (negative wealth). This is a dramatic increase from rates seen in 2007 when 18.6% of American households held either zero or negative net wealth (Worstall, 2011).

The most recent statistics available on wealth disparity are for the year 2010. Joseph Stiglitz, a professor at Columbia University and a prominent progressive economist, published that in 2010, the richest 1% of the population received nearly 25% of all income earned and that the richest 1% controlled nearly 40% of the nation's total private wealth. These findings were published in Vanity Fair magazine and demonstrate the lack of academic focus placed on the topic of wealth disparity. In comparing Wolff's and Stiglitz's findings, one sees that 5.4% of American total wealth migrated from the ownership of the 99% to the 1% from 2007 to 2011.

The graph below represents the change in wealth owned by the richest 1% as a ratio of median household wealth and that a sinking tide does not lower all boats. The spike from 2007 to 2009 demonstrates the housing bubble's increasing effect on wealth disparity. In 2009, the wealthiest 1% of households had net wealth valued 225 times greater than the median household's total net wealth. This is a tremendous and unprecedented leap from the ratio of 180:1 seen in 2007. The ratio of what the richest 1% of household's earned in 2009 compared to typical household net worth is the most disparate ever recorded in American history (Allegretto, 2010).

Figure 2 Comparison of the 1%'s Wealth to Median American Wealth (1962-2009)



Source: My personal graph based on data from Wolff 2010's Working Paper 589 that Allegretto compiled

However, this is not to say that the wealthiest of Americans didn't also lose something in the financial crisis. Pretty much everyone became poorer together; however, the rich lost proportionately less than the rest. It is unclear how much the richest 1% lost because there is no definitive measure of personal wealth, especially the wealth of the 1%. According to data from the Federal Reserve, one source said that from 2007 to 2009, the minimum amount of wealth needed to join the ranks of the 1% dropped by 23% to \$6.9 million (The Economist, 1%, 2012). However, other statisticians contend that the entry to the top 1% in 2009 ranged from \$1.5 million to \$9 million, demonstrating the challenging (and also potentially politically motivated) nature of measuring wealth disparity (Kennon, 2011).

Note that in Figure 2, right before the housing bubble burst in 2007, the richest American's slice of the wealth pie did decrease slightly. During this time, most politicians and

political commentators publicly stated that the growing housing market was an example of a healthy economy. For example, in 2005, Bernanke denied the possibility that the growing housing market could result in the pop of a financial bubble (Inside Job, 2010). Due to the common consensus about the safety of the growing housing bubble, the nation was not prepared to deal with the aftershocks of the bubble's collapse. Nonetheless, the growing housing bubble led to a national and global recession that subsequently increased wealth disparity.

Gradual increasing wealth disparity is expected in a capitalist economy; however, bursts of increasing disparity are unprecedented. For this reason, it is crucial to understand the causes of the financial crisis in order to understand how it contributed to further wealth inequality in the country. The questions then arises: what are the commonalities between the spike in wealth disparity and the Great Recession, and does the government have a social, democratic, or economic responsibility to deal with rising inequality?

#### **IV. Causes of Increased Wealth Disparity during the Great Recession: Debates across the Political Spectrum**

Just as the financial crisis exposed the Madoff financial ponzi scheme, the financial crisis of 2008 exposed significant trends that contributed to increasing wealth disparity in the country. Although, increasing inequality did not cause the Great Recession<sup>2</sup>, the root causes of the financial crisis are the same as the causes of growing wealth inequality: a growing financial sector and growing financial sector power within politics. When the housing bubble peaked in

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<sup>2</sup> There is a field of literature specific to the idea that rising inequality precipitates economic collapses (for example Kumhof and Ranciere's 2010 paper). See Appendix 2 to note the correlation between income disparity and recessions.

2007, economic disparity (both income and wealth) also peaked in the country nearing a divide that verged on inequality levels last seen in the Great Depression.

The financial crisis did much more than increase the wealth gap; for example, it doubled the national debt, pushed 30 million people into unemployment, and spurred a global recession (Inside Job, 2010). The financial crisis is synonymous with the housing bubble, the trading of mortgage backed securities, and the foreclosure crisis. The worth of mortgage-backed securities crumbled after millions defaulted on their mortgages. Investment banks were left with toxic assets that no one wanted and, for this reason, one of the world's largest investment banks, Lehman Brothers, filed for bankruptcy once housing values plummeted. A few days later, the world's largest insurance company, AIG, followed suit. Millions lost the wealth they had invested in houses and stocks. At the same time, a financial elite comparatively prospered and gained wealth by shorting the financial market (Inside Job, 2010).

The next portion of my paper is an attempt to reconcile why wealth disparity increased dramatically during the financial crisis when it had previously risen at a fairly constant rate since the 1980s. I present data collected from primary and secondary sources on perceptions of causes of the Great Recession. Despite how the range of informants can not agree on the primary cause of the financial crisis, all of the Great Recession's causes are rooted in increasing wealth disparity. Libertarians argue that the culprit of the financial crisis was federal home ownership policy. Conservatives argue that new homeowners spent irrationally beyond their means. And, Occupiers claim that greedy banks selfishly profited off of the financial market at the expense of the American people and economy.



## **The Federal Government's Housing Policies**

Wary of an economic downturn and stagnant average incomes, presidents and Congresses since the early 1990s sought to encourage further homeownership as an attempt to revitalize the economy. In the last twenty years, the federal government encouraged the growth of homeownership directly as well as indirectly, contributing to the burst of the housing bubble in 2008. Raghuran Rajan, a professor of finance at the University of Chicago, who among other duties has served as the International Monetary Fund's chief economist, points an accusatory finger at the government for not only letting the financial crisis happen, but for also facilitating the dangerous growth of the mortgage crisis. Rajan asserts that the federal government designed policies that increased homeownership by opening the flood gates of available mortgage credit to all, which later contributed to the riskiness of the market (The Economist, March 2012).

In the mid-1990s, government policies encouraged government sponsored mortgage financiers, Fannie Mae and Freddie Mac, and the federal mortgage insurance agency, the Federal Housing Administration, to reduce the amount of capital needed for customers to take on home mortgages. These policies especially enabled low and moderate income wage earners to be able to take out more loans (The Economist, March 2012). Thomas Murphy, who is the Managing Director of Derivatives at Wedbush Securities, said that these policies encouraged irresponsible behavior since "income verification mandates were thrown out the window and loans were made to irresponsible people that can't even pay their phone bills." Federal policy said banks could ask for as low as an initial 5% down payment on a mortgage, a dramatic drop from the minimum requirement of 20% seen in the early-1990s (Interview, Murphy, 2012). Additional new legislation in the '90s also called on these agencies to increase the number of mortgages that they

gave out (The Economist, March 2012). Thus, the federal policies of the '90s called on the issuance of more mortgages at riskier rates.

Apart from federal legislation that encouraged banks to increase its mortgage lending rates in the late 20<sup>th</sup> century, Murphy specifically attributes the financial crisis to new federal legislation enacted in the early 2000s. (However, self-declared libertarian, Murphy blames the government for a lot more than just the financial crisis.) In the 2000s, the federal government further promoted increased homeownership by mandating that Fannie and Freddie buy more mortgage-backed securities<sup>3</sup> (Murphy & The Economist, 2012). An anonymous Executive Vice President at Wedbush Securities explained, that therein lies the rub: by promoting policies with the intention of encouraging homeownership, the government inadvertently encouraged banks to issue subprime loans that ran the risk of not being paid back because banks knew that Fannie and Freddie were interested in buying securitized mortgages. These federal government policies offered a profitable avenue for banks where banks could make sub-prime loans and also not be responsible for them. Banks otherwise might not have made subprime loans that risked not being paid back. Because Fannie and Freddie were buying mortgage-backed securities, banks bundled subprime mortgage-backed securities and sold them to investors. However, the government did not anticipate the following mass proliferation of subprime mortgages, mass defaults, falling home values, nor the subsequent market crash.

### **Irresponsible Borrowers**

A largely conservative argument blames irresponsible borrowers for the financial crisis. Some, like an anonymous Executive Vice President at Wedbush Securities, argue that the federal

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<sup>3</sup> Similarly, today in 2012, the Fed is advising the government to purchase mortgage backed securities to safeguard the economy.

policies that spurred the housing bubble in it of themselves are not to blame for the financial crisis (Interview, 2012). For, these policies simply wanted to encourage the American dream: to mindlessly consume as much as possible. Rather, they say that the majority of the blame lies with irresponsible borrowers that sought to live beyond their means.

Increasingly, banks offered subprime mortgages, which are characterized by their relatively high credit risk, suggesting high interest rates or fees and that creditors may not have the means to pay back their loans. Customers were hasty to own new and better things and as a result, they took advantage of generous loans. From 2000-2003, during the peak of the housing boom, the number of mortgages loaned to Americans nearly quadrupled (Inside Job, 2010). Once the fine print of the subprime loans caught up to the new home owners, Americans dug into their savings and frequently delved into debt (negative wealth) to pay off the monthly interest payments on their mortgages. American wealth especially began to vanish when homeowners could no longer afford to pay back their mortgages and were foreclosed on, losing the wealth they had placed within their homes as well as their saved wealth used on previous mortgage payments.

### **Banks Issued Sub-Prime Mortgages to Turn a Profit**

An alternative explanation asserts that banks, as opposed to bank customers, are at fault for the spurring-on the financial crisis by their proliferation of subprime mortgages. For, a customer assumes that if a bank approves them for a mortgage that they, the customer, are in fact capable of paying the mortgage (Lee, Interview, 2012). Two individuals, one the Los Angeles head of Move to Amend and the other a representative of the Party for Socialism and Liberation,

argue that greedy businessmen involved in Wall Street intentionally “screwed over” the American public to turn a profit.

Banks and financial institutions were handed an opportunity to make exorbitant amounts of money that they could not refuse. Banks knowingly made bad loans because they knew that they would later bundle up the risky loans and securities and offer them to be speculated on by the tumultuous market - these securities were no longer their responsibility. Banks were not preoccupied with customers defaulting on their mortgages because the FDIC insures commercial bank deposits. So, if customers defaulted on their loans, banks were not affected, explained Tom Eilers a proprietary trader at Wedbush Securities in an Interview (2012). And if banks were not worried about the riskiness that these loans entailed they did not feel ethically inclined to stop extending credit to individuals that could not feasibly pay their mortgages or their mortgages interest rates (Interview, Eilers, 2012). And as already mentioned, banks knew that the government mortgage suppliers were eager to invest in mortgage-backed securities because of federal mandates.

The growth of the securities food chain to include subprime mortgages offered banks an avenue to get rid of their risky loans. The securitization food chain was executed by Bank of America, for example, selling off its subprime mortgages to a hedge fund like AIG or an investment bank like Goldman Sachs where AIG or Goldman Sachs would then find investors willing to buy mortgage-backed securities. Although the possibility of mortgage defaults was high, especially regarding sub-prime mortgages, commercial banks ensured investors on the safety of their securities and gave the securities AAA ratings.

Banks were enticed by the influx of new mortgages that sub-prime mortgages brought in and the corresponding new commissions that these mortgages brought in. EXPAND

## **Banks Went on a Foreclosure Spree**

Commercial banks were eager to offer as much credit as possible because there was a high demand for mortgage-backed securities in the investment world. Before the crisis, banks eagerly advertised the safety of mortgage-backed securities while privately knowing that they harbored a great amount of risk. Investors were profiting off of mortgage payment installments, but once banks began foreclosing on customers, mortgage payments stopped. Apart from demanding their dividends, investors were eager to cash-out of the market and get all of the money back that they had invested in the subprime backed mortgages. Banks were in a scramble to appease their investors. Banks attained some of the money investors needed by foreclosures due to bank customers being unable to repay their loans. However, banks also haphazardly foreclosed on homes in order to collect the money needed to pay off investors.

Without paying attention to foreclosure protocol, banks foreclosed on millions of households in a hasty rush to pay back investors. Francis of the Party of Socialism and Liberation who also works at a Pasadena based real estate firm explains that the system did not make sense. Because mortgages had been securitized and re-securitized as a type of a derivative, called a collateralized debt obligation, banks didn't necessarily know which bank owned which house. Collateralized debt obligations are financial securities made out of various forms of debt, like home loans, student loans, credit card debt, or car loans, that get turned into securities so that they can be speculated on (Inside Job, 2010).

Additionally, banks did not have the capacity to always determine which customers actually had defaulted on their payments. Even faithful mortgage borrowers were accidentally foreclosed on and they were not always necessarily foreclosed on by the bank that they took out the mortgage from (Interview, Francis, 2012).

Before an Occupy Los Angeles General Assembly, Daniel, of Move to Amend, explained the process of how banks unethically collected money to repay financial investors. In order for a bank to foreclose on a house, foreclosure documents require a third party notary. To efficiently foreclose on homes to procure investors' earnings from shorting the market, banks utilized an electronic filing system for mortgages called MERS, or colloquially known as robo-signing (Interview, Brady, 2012). Robo-signing was used as a blind rubber stamp to vouch that a customer deserved to be foreclosed on even though frequently no research was done to verify that indeed customers had missed mortgage payments (Interview, Daniel, 2012). In 2008, the first year of the foreclosure crisis, over 2 million households were foreclosed on, this is a 225% increase in foreclosures from 2006 (RealtyTrac, 2009). Again, this is a clear explanation of how wealth migrated from the bottom 90% to the top 1%. Today, foreclosures continue, many of which are conducted without any type of oversight. In February of 2012, 1 in every 637 housing units in the country received a foreclosure filing (RealtyTrac, 2012).

Table 3 depicts why the burst of the housing bubble led to a dramatic divide in wealth disparity in the United States. The nation's least wealthy were dramatically more impacted by falling home values compared to the nation's wealthiest since the bottom 90% is much more likely to have most or all of their wealth in their housing property. This demonstrates that new homeowners were not the only ones to suffer a loss of wealth, but the nation's home owners lost wealth as housing values dropped.

**Table 3 Wealth in Principal Residence –  
2007**

Top 1%	Next 9%	Bottom 90%
9.40%	29.20%	61.50%

Source: Wolff, 2010

Within the bottom 90%, those that were most likely to take out sub-prime mortgages, were those that couldn't afford mortgages under more stringent loan regulations. Sub-prime mortgage borrowers were not required to have a steady income nor own assets. Thus, individuals that took-on sub-prime mortgages had little wealth to begin with. Once interest rates began to sky-rocket, borrowers were forced to either pay high amounts of interest or banks foreclosed on their homes. Both had the effect of hollowing out lenders' wealth.

### **Greedy Financial Moguls**

Investment banks knowingly coerced the sub-prime mortgage market to grow. The sub-prime investment market during its growth was extremely profitable for some investors in two ways. One way is that investors at hedge funds and investment banks profited off of increased commissions as they persuaded other investors to place their money in risky securities. Also, some investors profited off of risky derivatives, specifically collateralized debt obligations, by later shorting the same securities that they had previously promoted. Jeffrey Sachs, an economics professor at Columbia University, claims that financial institutions like JP Morgan and Goldman Sachs intentionally created "securities designed to fail in order to defraud unsuspecting purchasers" (TIME, 2011). Sachs is referring to collateral debt obligations (CDOs). CDOs are a type of complex derivative that was used extensively during the housing boom. CDOs are financial assets that were bundled and re-bundled, or leveraged, to form various sorts of loans.

Mark Levy of Wedbush Securities finds fault with the increased use of leveraging that happened on Wall Street before the onslaught of the financial crisis. He said that banks leveraged securities at unprecedented rates by creating an abundant supply of securities off of debt (Interview, 2012). Commercial banks sold loans such as home loans, student loans, credit card

debt, or car loans to investment banks. Investment banks then created financial assets out of these loans.

The Investors that bought these securities would be paid back their credit over time as debtors. Instead of repaying banks, creditor payments were used as dividends. The money would pass from the debtors, to commercial banks, to investment banks or hedge funds to the investor. This can be called the security food chain' (Inside Job, 2010). The head of Move to Amend Los Angeles explained that not all of the investors that sought to make a profit on mortgages came out on top. Many unassuming average-Joe's lost a tremendous amount of their financial wealth once the value of mortgage-backed securities went down. Investors encouraged clients to invest in mortgage-backed securities. Clients, many with pension and retirement funds, were advised by investment banks and hedge funds to place their money in CDOs. They strongly recommended CDOs because they were highly rated.

Credit rating agencies ranked CDOs as some of the safest securities to invest in with either AA or AAA ratings. Rating agencies, like Moody's, Standard and Poor's, and Fitch were not liable whatsoever if their ratings proved wrong. For this reason rating agencies had no incentive to rate securities honestly. Lee and the documentary *Inside Job* purport that investment banks paid credit rating agencies to give CDOs high ratings. Since there was no fear of reprimand, credit rating agencies appealed to investment bank interests and followed the money (Interview 2012). Investment banks and hedge funds wanted ignorant investors to place their wealth in risky CDOs because this correlated with more profit for financial businesses and their employees (Inside Job, 2010).

Investment banks were eager to promote collateralized debt obligations because they entail more profit for investment banks than other financial securities. Collateralized debt



obligations correspond with higher interest rates. This suggests that commission payments to employees at investment banks are also higher because these securities are associated with high interest rates compared to other securities. High interest rates appealed to potential investors as well as to investment banks that profited off of higher commission rates and increased investment bank profit. The more risky CDOs were sold, the more profit investment banks made. This is similar to the idea that the more sub-prime mortgages banks issued, the more profit banks incur. Commercial and investment banks intended to maximize the volume of transactions made because increased transactions lead to increased profits. If banks made more money by encouraging the growth of sub-prime loans, then banks will encourage policies that revolve around sub-prime loans (Inside Job, 2010).

However, many investment bankers understood that they were playing with fire and that CDOs were in actuality not worth their AAA ratings. So, in-the-know investors “shorted” the same securities that they promoted. In trying to explain to me what shorting means, Samantha McAfee of Wedbush Securities admitted that the practice does not make rational sense. (She further stated that she thinks that the practice should be illegal.) To short an asset implies that an investor borrows money from someone else’s investment to make a side bet on the financial market in time to pay back the asset to the initial owner. When investors short the market, they hope that the value of the asset will go down. Investors in hedge funds during the financial crisis profited off of deteriorating stock values as homebuyers foreclosed on their newly purchased homes and mortgage-backed securities became worthless. Unlike the trade of other securities, which entail a lot of luck and good intuition, these investors knew insider information that led them to bet that the securities would go down. Bankers shorted the value of CDOs that were

comprised of the same mortgages that their banks gave out. Simultaneously, bankers and investment banks were promoting others to buy these assets.

Based on inside information and their desire for profit, credit rating agencies and employees at financial firms single-mindedly promoted their own interests by encouraging investors to buy securities they would later bet against. Such self-interest contributed to an unprecedented growth in a wealth divide as homeowners began to default on their loans and shareholders' securities became worthless. While an elite prospered, a large part of the '99%'s' wealth was obliterated. But, then again, credit rating agencies, commercial banks, hedge funds, and investment banks are businesses. The representative of the Socialist party that I spoke to taught me to not be surprised by such market failure. After all, crises are unavoidable because the market system is fundamentally flawed and accumulation of wealth is inherent in capitalism (Francis, Interview, 2012).

At the surface, there are clear reasons of what caused the financial crisis and I further found links between these causes and increasing wealth disparity. Considering the causes that increased wealth disparity during the Great Recession, it appears that there were victims and perpetrators responsible for the growing divide. I will further argue that wealth disparity grew during the Great Recession because the American government is unable to protect American citizens from financial sector interests.

## **V. The Rise of a Financial Elite and Growing Wealth Disparity**

### **Financial Sector Deregulation before the Financial Crisis**

There has been a growing presence of a financial elite within politics, which has had the effect of a growing number of policies that favor the financial elite at the expense of ‘the 99%’, and has had subsequently increased wealth disparity. Financial sector power and wealth have steadily increased since the 1980s partially due to the reinforcing impetus of an increasing number of free market enthusiasts in federal government, the maintained deregulation of the financial sector, financial money in politics, and the federal government’s inability to regulate the financial sector that it does have authority to regulate. As an acclaimed institutional economist notes, incurred wealth and power becomes self-perpetuating because “the greater the disparity in resources, the greater the ability of an elite to frame the rules in such a way as to preserve their relative political power” (North, 1991, 25). This proves to be particularly troubling since it corresponds with increased political control for those that can buy policies and politicians and thus an analysis of increasing wealth disparity forewarns that the demise in American democracy is upon us. Late Justice Jouis Brandesi aptly noted the contradiction between wealth disparity and democracy in that “we can have democracy in this country, or we can have great wealth concentrated in the hands of a few, but we can’t have both” (Lenzer, Forbes, 2011).

At the onslaught of his presidency in 1981, Ronald Reagan set a trajectory that increased a financial elite’s ability to amass wealth and political power that continues today. He introduced an anti-regulatory paradigm that has since become a core of conservative fiscal policy initiatives. During his first term, President Reagan extended the possibilities to Donald Regan to leave his position as Merrill Lynch’s CEO to become Treasury Secretary, Alan Greenspan to head the Federal Reserve, and Larry Summers to be a part of the staff of the Council of Economic

Advisers. Under the policy guidance of such individuals, financial markets were liberalized and the unregulated growth of the financial market encouraged (Inside Job, 2010). Fiscal conservatives argue against regulation because they claim that increased financial market liberalization is conducive to economic growth and that the government has no place to interfere with the market dynamics of supply and demand.

Other economic theorists argue to the contrary of conservative fiscal ideology and contend that outside regulatory enforcement is crucial for economic growth. Engerman and Sokoloff say, “the nature of the enforcement of institutional<sup>4</sup> provisions is critical to the success of whatever institutions exist” (2003, 8). Regulation is essential because it prevents the further growth of “extractive institutions, which concentrate power in the hands of a small elite and create a high risk of expropriation for the majority of the population” (Acemoglu et al., 2002, 1235). Further, regulation is imperative because it deters the growth of extractive institutions, which is necessary because “extractive institutions are likely to discourage investment and economic development” (Acemoglu et al., 2002, 1235). Extractive institutions have proven to have a negative relationship with the growth of institutions that promote property rights, and the development of property rights has indisputably been tied to sustained economic growth. This demonstrates that extractive institutions, which generally arise from the concentration of an elite’s power, have a negative relationship with sustained economic growth. Without internal or external regulation of various aspects of the financial sector it is of no surprise that the further deregulation of the financial sector led to economic collapse as opposed to the intended economic growth.

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<sup>4</sup> North defines institutions as “humanly devised constraints that structure political, economic and social interactions.”

Under Reagan's presidency, the derivatives market, a market that played a pivotal role in the financial crisis, grew unabashedly. Greenspan and Summers' power within politics extended past the Reagan administration and they later pioneered the re-introduction of proprietary trading and encouraged the unregulated growth of the derivatives market asserting the need for limited regulation to spur ideal economic growth (Inside Job, 2010). A financial elite was, and still is, able to pine for policies that favor their profit-seeking interests by utilizing a revolving door between the financial sector and public office, financial lobbying, finance-based campaign contributions, and a strong ideology that less regulation is best.

### ***The Derivatives Market***

In finance, the derivatives market is the largest part of the financial sector that is unregulated. Derivatives are contracts that guarantee the buying and selling of commodities and financial goods at a future date.<sup>5</sup> The use of derivatives has been intrinsic to how people have conducted business for centuries and the first documented use of derivatives precedes the life of Christ by nearly two millennia (Interview, Wandschneider, 2012). The practice of speculative trading of derivatives has existed since the 17<sup>th</sup> century, whereby investors sought to profit off of the changing values of securitized derivatives. Since its prevalence in human history predates the use of the western toilets and British imperialism, it can be assumed that derivatives have received unfair notoriety in liberal media. As mentioned earlier, internal and external regulation of an institution are crucial for continued economic growth and the flaw with the derivatives market is that it has grown at exponential rates at the direction of individuals that seek to profit off of its growth uninhibited by regulation.

Businessmen as well as policy makers first began to acknowledge the derivatives trading market's affinity for growth in the 1980s. At this time, management schools were first graduating

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<sup>5</sup> To gain a better understanding of what a derivative is, reference my explanation in End Notes 3.

students that were fluent in the ability to comprehend how to profit off of the derivatives trading market and speculators were eager to see this market grow (Chance). Also, economic policy advisors saw an opportunity to expand economic output by encouraging the growth of an emerging market. Free-market enthusiasts within the Reagan administration preached that to obtain optimum growth, policy makers needed to acknowledge that the emerging market needed to remain unburdened by regulation (Inside Job, 2010).

By the late 1990s, the derivatives market was a growing \$50 trillion unregulated market. To put this number in perspective, this market is nearing the globe's total GDP, which in 2008 was \$61.3 trillion (World Bank, 2010). But, whereas countries' domestic incomes have been cultivated for centuries, the derivatives market grew to its current value in just decades. This specter experienced tremendous growth rates due to a lack of interference from regulatory agencies.

Once it began growing, the derivatives trading market's growth was fostered by the same individuals that wanted it to grow without any oversight from regulatory agencies. A policy debate surrounding the derivatives market began to emerge in the 1990s. The head of the Commodity Futures Trading Commission (CFTC), Brooksley Born, viewed the unregulated behemoth as potentially dangerous and sought to regulate the derivatives market. The CFTC released a report with analysis and recommendations from regulators, academics, and practitioners to aid in the derivatives market's further growth. However, this report was met with fierce resistance. Bank lobbyists and powerful fiscal conservatives such as Larry Summers (the current Treasury Secretary), Alan Greenspan (the head of the Federal Reserve), Robert Rubin (the Treasury Secretary and previous CEO of Goldman Sachs), Arthur Levitt (the SEC chairman), and William Rainer (an employee of the CFTC under Born) retaliated. Whereas Born

and her team's report from the CFTC provided ample evidence to support their reasoning how and why the derivatives market needed to be regulated, Larry Summers simply retorted "the parties to these kinds of contact are largely sophisticated financial institutions that would appear to be eminently capable of protecting themselves from fraud and counterparty insolvencies" and gave no further proof as to why he believed the CFTC's report to be inadequate (CFTC, 1998; Friedman et al, 2011, 125). Despite the lack of argument on the behalf of team pro-free-market, Congress still ruled in their favor. This may be a result of the high levels of lobbying that banks employed (Inside Job, 2010). Whatever the reasoning why the CFTC's report was dismissed, the coalition formed between financial interests and policy makers set the precedent that financial interests will be those that ultimately dictate the extent of financial sector regulation.

To prevent another attempt to regulate the derivatives market, the Commodity Futures Modernization Act was passed by Congress in 2000 (Inside Job, 2010). This Act, which passed under the Clinton administration, banned regulation of the derivatives market. The Act declared that derivatives were separate from futures and securities and did not need to be supervised like other financial instruments (Inside Job, 2010). Just as the fiscal conservative paradigm asserted, deregulation of the market led to its abundant growth. From 1998 to 2008, the number of derivatives traded increased by 100% (Harring et al, 2008). Although the derivatives market grew, it did so at the expense of American democracy as well as at the expense of a sustained and safely growing economy.

It is unclear whether economic growth was the only goal that policy makers had in mind in their intent to deregulate the derivatives market. It can be questioned whether policy makers had a conflict of interest in promoting the economic growth of institutions that traded derivatives. For example, the documentary Inside Job claims that Larry Summers made \$20

million as a consultant to a hedge fund by encouraging the trade of derivatives (2010). Whether this raises ethical concerns or not, Summers' compensation raises questions regarding the revolving door theory, a theory which entails that regulators with professional ties in the industry that they regulate might favor the industry that they are supposed to police. Thus, policy makers may have also been blinded by potential profit and did not foresee the devastating impacts an unregulated derivatives trading market might have on the economy.

In the early 2000s, a financial elite used their institutional know-how of trading derivatives to amass profits while placing risks on the unsuspecting. A subsection of the derivatives market grew tremendously with the booming housing market. Collateralized debt obligations influenced the growth and the collapse of the housing bubble. Collateralized debt obligations are a type of complex derivative that are made out of various forms of debt, like subprime mortgages, that get turned into securities that may later be speculated upon and the buyer of the security is guaranteed her money back in the case of default. In 2008, the credit default swap market was unregulated and worth \$47 trillion (Harrington & Moses, 2008).

An expanding unregulated sector proves cause for concern in that its institutional growth may reflect the interests of the institution's elite as opposed to what is optimum for economic growth and society's well-being. As a result an elite set of financial businesses has grown to prominence and their growth and their singular profit-seeking motives have led to consequences for the nation at large.<sup>6</sup> This is understood in the role that increased derivatives trading influenced the growth and the collapse of the housing bubble.

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<sup>6</sup> These include 5 investment banks: Goldman Sachs, Morgan Stanley, Lehman Brothers, Merrill Lynch, and Bear Stearns; 2 financial conglomerates: Citigroup and JP Morgan; 3 securities insurance companies: AIG, MBIA, and AMBAC; and 3 credit rating agencies: Moody's, Standard & Poor's, and Fitch



## ***Proprietary Trading***

Another unregulated sector that contributed to the demise of the American economy in 2008 is the institution of proprietary trading, which allows for banks to trade commercial money as if it were investment money. This is seen in banks ability to speculate against derivatives made of sub-prime mortgages that they had lent out with their customers' commercial money. In 1929, proprietary trading had similarly played a tremendous role in bringing about the Great Depression and in 1933, Congress passed the Glass-Steagall Act to prevent the future use of proprietary trading and hopefully prevent a future financial meltdown.

Had proprietary trading remained illegal, the 2008 financial crisis could have potentially been mitigated. However, under the Clinton administration, the Glass-Steagall Act was repealed in 1999. And similar to the deregulation of the derivatives market, the process of its repeal was undertaken with the best interests of financial businesses profits in mind.

The re-introduction of the legality of banks to engage in proprietary trading officially occurred after the fact that a merger between two banks violated the Glass-Steagall Act. In 1998, the commercial bank Citicorp and the investment bank Travelers merged to form the world's largest financial services company. Although, the merger was illegal at the time because it allowed for a single bank to engage in commercial and investment banking, the federal government's only response was to pardon Citigroup and exempt the bank from the stipulations of federal law for a year. As the year of exemption ended, Robert Rubin and Alan Greenspan urged the passage of the Gramm-Leach-Bliley Act, or colloquially known as the Citigroup Release Act. Similar to previous reasoning to liberalize the market, the repeal of the Glass-Steagall Act was promoted with the theory that it is best for the market to take care of itself and that regulation is detrimental to economic efficiency. The Gramm-Leach-Bliley Act overturned

Glass-Steagall and cleared the way for future mergers that incorporated commercial and investment banks into the same business (Inside Job, 2010). Without doubt, Citigroup would not be one of the world's largest financial conglomerates if the Glass-Steagall Act had not been repealed and had the convergence of commercial and investment banking (in other words, proprietary trading) remained illegal.

Apart from 'encouraging economic growth' repealing the Glass-Steagall Act created a profitable avenue for individuals that participated in proprietary trading. The documentary *Inside Job* highlights how politicians benefited from the same legislation that they promoted as well as highlights the effects of the revolving door theory, a theory that entails that regulators with professional ties to the industry that they regulate might ultimately favor that industry instead of policing it. For example, Robert Rubin, after working for Goldman Sachs for 26 years, two of which he was co-chairman, was appointed Clinton's Secretary of the Treasury for both of Clinton's presidential terms. Some attest that those that can provide guidance for the financial sector are those that had worked within it. However, Rubin's lengthy experience within the financial sector might have tainted the way that he views federal level financial policies. Apart from his public position as Secretary of the Treasury, Rubin also held the positions of Director of the National Economic Council from 1993-1995 and in 2007 he was the Chairman on Council of International Relations. Rubin was the Secretary of the Treasury when Citigroup violated the Glass-Steagall Act. Although Rubin was appointed to office because of his vast experience and understanding of the financial sector, he proved inefficient at upholding the law in this specific case. Thus, it seems contrary to the public's interest that after Rubin allowed the merger to go under way without public comment or reprimand despite Citigroup's blatant disregard for the law, Rubin later worked at Citigroup once his terms in public office ended. Rubin then reaped

the benefits of working for an enlarged Citigroup; he Rubin cashed-in on \$126 million dollars worth of cash and stock options after his resignation from Citigroup in 2009, during the heart of the financial crisis (Inside Job, 2010). Thus, Rubin helped pass legislation that contributed to the growth of the housing bubble and its subsequent collapse, but left the financial sector once earnings started going south partially due to the effects of the reintroduction of proprietary trading. Despite Rubin's clear profit off of the revolving door between public office and private sector, other aspects of government regulation similarly have proved incapable to regulate the financial sector due to the lure of profit the financial sector offers.

### **Strengthening Financial Elite after the Financial Crisis**

After the housing bubble burst, the federal government only passed legislation that favored, instead of reprimanded, the financial sector (apart from the Dodd-Frank Act, which will be discussed later), despite the acknowledgement that the financial sector largely contributed to the Great Recession. For example, Citigroup contributed to the financial crisis by collaborating in the buying and selling of risky collateralized debt obligations. A part from its contribution to spurring the Great Recession, Citigroup lost its investors \$700 million worth of assets. However, no government outside forces stepped in and raised concern that a business and its employees profited from Citigroup's own risky behavior. Citigroup made an estimated profit of \$160 million from its risky transaction (Sachs, TIME, 2011). Rather, Citigroup was a recipient of generous loans and stimulus packages from the Federal Reserve and from the federal government. A lack of negative consequences for engaging in risky activities can be attributed to, not only the utilization of the revolving door, but to financial sector money in politics as well

as to a prevailing ideology that markets should be uninhibited, which in turn blinds government actors to other opportunities of how to deal with financial sector predicaments.

The first federal-level response to the financial meltdown came from the Federal Reserve. An article from Bloomberg Publications critiques these loans made to Wall Street businesses as handouts that extended credit and refuge to businesses that profited off of the financial crisis (Ivry et al., Bloomberg, 2011). Before the federal government agreed to pass the Troubled Asset Relief Program (TARP), a program that bailed banks out by buying equity in their businesses, with the intent to prevent further economic crisis, the Federal Reserve loaned trillions of dollars at low rates to financial businesses unbeknownst to the government or to the public.

The Federal Reserve colluded with financial institutions and, in total, the Fed gave the financial system trillions of dollars from 2007 to 2009 (Ivry et al., Bloomberg, 2011)<sup>7</sup>. The extent of Federal Reserve loans to Wall Street remained private information until March 2011. Ultimately, transparency was achieved as a result of a lawsuit that reached the Supreme Court. In 2011, the Supreme Court dismissed an appeal by the Federal Reserve and Clearing House Association LLC, a group that represents the United States' largest banks. In light of the appeal's dismissal, Bloomberg LP, the parent of Bloomberg News, won the court case. The verdict was that the Fed and Clearing House release all of their lending details during the financial crisis of 2007. This information revealed that the Federal Reserve loaned \$7.77 trillion dollars, more than half of the value of everything produced in the U.S. to financial businesses, to banks that were "too big to fail" (Ivry et al., Bloomberg, 2011). After the exposure of the loans, the Federal Reserve claimed that it was crucial for the well-being of the economy to offer loans to the commercial and investment banks that played pivotal roles in the financial crisis. The six greatest

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<sup>7</sup> The \$7.77 trillion dollar figure is the total of all loans given out by the Fed to the banks and does not take into account that at some points the banks had repaid their debts before taking on new ones (Eilers, Interview, 2012).

beneficiaries of the Fed's money were JPMorgan, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley, which all knowingly played detrimental roles in the housing bubble and its burst.

A threat to democracy arises in the lack of transparency of these actions and the resulting effects this lack of transparency had on the economy. The Federal Reserve did not disclose to the public nor the government the extent of loans that they issued to "too big to fail" banks that were going under and rather encouraged the federal government to be generous in its bailout package. TARP, created in 2008, intended to save the American economy from further collapse. The Federal Reserve advised the government that the largest financial businesses were "too big to fail" and that their downfall would lead to American ruin. Purportedly, Bernanke said that if the banks were not bailed out "unemployment would rise – to 8 or 9 percent from the prevailing 6.1%" (Business Plus, 2010). Under the direction of Ben Bernanke, the head of the Federal Reserve, and Henry Paulson, former CEO of Goldman Sachs and a former Secretary of the Treasury, the federal government gave out loans to commercial and investment banks that these individuals knew were on the verge of collapse.

Similarly, banks assured investors that their firms were healthy and that investors should have faith in their businesses without mentioning that they were receiving loans from the Federal Reserve. Ideally, a strong economy is determined by all parties having perfect information regarding a market. Although the Federal Reserve claimed that such loans were necessary to preserve the economy, it seems that ultimately, these decisions were made by profit-seeking motives.

Saved by the bailout and continued investment, banks and bank executives actually prospered. Although share prices of the nation's largest financial companies declined, the value

of the total assets held by the six biggest U.S. banks has increased 39% from \$6.8 trillion in 2006 to \$9.5 trillion in 2011 (Anonymous, Interview, 2012). Similarly, compensation rates continued to rise during the crisis. Based on data from the Bureau of Labor Statistics in 2010, all employees at the six largest American banks made at least twice as much pay as did the average American worker. These compensation rates parallel those seen in 2007 before the financial crisis hit (Ivry et al., Bloomberg, 2011).

With the additional income and the awareness that money buys policies, banks increased the amount of money spend on lobbying against government regulation (Ivry et al., Bloomberg, 2007). The six largest banks increased their lobbying expenditures by \$7 million dollars from 2006 to 2010. In 2010, the six largest banks spent \$29.4 million dollars lobbying against legislation. Considering that the public was not aware the dire position of banks in the country due to the secrecy of the Federal Reserve's loans, policy makers were open to the material that bank lobbyists showed them – since lobbyists provide policy makers with the majority of information that policy is based off of.

An example of financial lobbying is seen in the defeat of the proposed Safe Banking Act. In April of 2010, Brown and Kaufman proposed an amendment that mandates the nation's six largest firms shrink their size. In response, financial lobbies came out in full force. Financial lobbyists asserted that larger banks are more stable and ensure international competition. Further, these lobbies argue that if the nation's largest jobs were broken-up, then the nation would lose jobs. Timothy Geithner, the Secretary of the Treasury, personally lobbied. In a meeting with Senator Kaufman, Geithner argued that Congress was incapable of addressing and correcting the financial market. Rather, Geithner said, it is best to keep these matters to individuals that best

know how the market operates. Bank lobby expenditures proved fruitful. The Brown-Kaufman Safe Banking Act was defeated<sup>8</sup>.

Even if politicians were skeptical of the data that financial lobbyists provide, they are easily enticed by the campaign contributions that financial interests offer. Financial businesses compose a significant portion of funds to political campaigns. Financial institutions donate heavily to both Democratic and Republican candidates. Finance-oriented campaign contributions made up a total 50% of both Democrat and Republican campaign contributions in 2010. (OpenSecrets, 2012).

In the 2008 presidential campaign, financial businesses were major campaign contributors<sup>9</sup>. Five out of President Obama's 20 greatest campaign contributors were financial institutions. These 5 contributors were Goldman Sachs (2<sup>nd</sup> highest contributor), JP Morgan Chase (6<sup>th</sup>), CitiGroup (7<sup>th</sup>), UBS AG (15<sup>th</sup>) and Morgan Stanley (19<sup>th</sup>). Twelve of presidential candidate John McCain's 20 greatest campaign contributions also came from financial interests. Money came in from Merrill Lynch (his primary campaign contributor), JPMorgan Chase (2<sup>nd</sup>), Citigroup (3<sup>rd</sup>), Morgan Stanley (4<sup>th</sup>), Goldman Sachs (5<sup>th</sup>), Wachovia (8<sup>th</sup>), UBS AG (9<sup>th</sup>), Credit Suisse Group (10<sup>th</sup>), Pricewaterhouse Coopers (11<sup>th</sup>), Bank of America (13<sup>th</sup>), Lehman Brothers (19<sup>th</sup>), and Ernst & Young (20<sup>th</sup>) (OpenSecrets, 2012).

Due to the revolving door between the financial sector and public office, financial lobbying, generous campaign contributions, and a strong free-market ideology, wealth disparity increased during the housing bubble, during its burst and during the Great Recession. Increased deregulation before the crisis and Federal Reserve loans and TARP bailout money encouraged

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<sup>8</sup> However, this is not to suggest that without the presence of powerful financial lobbies the Safe Banking Act would have passed. Actually, Senator Christopher Dodd of Connecticut (of the Dodd-Frank Act) was an opponent of the bill arguing that bank size alone will not prevent another financial crash (Herszenhorn, New York Times, 2010).

<sup>9</sup> The organizations listed below did not themselves donate to political candidates, but instead came from the organizations' PACS or individuals associated with the organizations.

the growing wealth of a financial elite as well as their growing political power. In such a way, the government assisted the further growth of a financial elite at the expense of taking care of these same banks' investors as well as taking advantage of tax payer money.

### **Demise in Democracy**

Due to the growing divide of wealth seen during the financial crisis, I claim that the federal government's ability to govern democratically is deteriorating and in its place a financial elite is rising to power. In its inability to withstand powerful interests from the financial sector, the federal government is losing its ability to govern democratically. According to a representative of the Party for Socialism and Liberation who I interviewed, a government is viewed as legitimate by its citizens if it is able to maintain control and stability of its society. Regarding the growing housing bubble and the Great Recession, the government demonstrated an inability to manage the financial sector and subsequently the entire American economy. The nation's second worst financial crisis ever was triggered by deregulating the financial sector and this was encouraged by financial sector interests in politics. As a result of the American government's inability to protect the economic well-being of American citizens, the American government is failing to provide guaranteed duties to its constituents. And, using the definition of democracy as a government that responds to the rule of law of the people, or the majority, the federal government is unable to effectively represent and protect the best interest of tax payers from financial sector interests. For this reason, the American democratic government has a responsibility to limit a further divide in wealth for the sake of its duty as a government to provide stability for its citizens.



## **VI. Never Again: An Analysis of the Dodd-Frank Act's Ability to Reconcile Growing Wealth Disparity and an Eroding Democracy**

After the Great Recession, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Obama in July of 2010 to say ‘never again’ to a potentially preventable economic collapse brought on by a financial asset bubble. The Dodd-Frank Act is the largest financial regulatory overhaul seen since legislation passed after the Great Depression and its mandates affect all financial regulatory agencies and nearly every part of financial markets. Jointly sponsored by the Democrat controlled Congress and the Obama Administration, the Act contains a sweeping 243 rules that span over 800 pages, which attempt to fix regulatory flaws within the American financial market that led to the financial crash and the Great Recession. Proposed by the Obama Administration in 2009 and revised by Barney Frank of the House of Representatives and Chris Dodd of the Senate Banking Committee, the Act seeks to “promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial service practices” (Dodd-Frank Act, 2012).

Broadly, the Dodd-Frank Act addresses regulatory holes exposed by the financial crisis and places increased comprehensive regulatory and enforcement power of financial institutions in the hands of the federal government. New limitations introduced by the Act are limitations on CEO compensation, proprietary trading, and the Federal Reserve’s power. The Act also created a new government agency, the Consumer Finance Protection Bureau to prevent financial institutions from taking advantage of financially illiterate customers. Many are optimistic in the changes that the legislation will bring about in the financial sector, and rightly so, because since

its implementation, the Dodd-Frank Act has successfully actualized changes that regulate the financial market to better support American citizens.

However, some claim that the Dodd-Frank Act will not provide the financial regulatory revolution that the nation is in need of and rather “puts lipstick on a pig” because it is impossible for a single piece of legislation to transform a failing sector especially while a financial elite still largely dictates the progression of financial regulation and because of an innate federal inability to regulate (Interview, Lee, 2012). The same powers that manipulated previous financial regulation since the 1980s to encourage the prosperity of the free-market played a pivotal role in deciding how laws are written and enforced and today still engage in debates about the implementation of rules within the Dodd-Frank Act. The presence of the financial elite’s involvement in policy making is noted in the Dodd-Frank Act’s ambiguous policies regarding the derivatives trading market. Despite the general acknowledgement that risky derivatives trading caused the Great Recession, what derivatives are and how they are to be regulated has yet to be specified in the Act (Burne, Wall Stree Journal, 2012). Further, despite the progressive intentions of the Dodd-Frank Act, there are structural challenges behind its implementation. As it stands, the financial sector is growing exponentially and government regulatory agencies are incapable of overseeing a sector that is growing at such tremendous rates.

### **‘Say-on-Pay’ Executive Compensation**

‘Say-on-pay’ legislation, a part of the Dodd-Frank Act, encourages democratic participation on executive compensation by reappropriating decision-making power regarding executive compensation and by enhancing transparency. Before 2010, executive compensation was determined secretly and independently by board members. The ‘say-on-pay’ policy mandates that information regarding executive compensation packages be publicized,

shareholders have the ability to vote on corporate executive compensation packages, and that salaries and bonuses reflect the profits or losses of a business.

The ‘say-on-pay’ legislation was drafted in response to concern over increasing executive salaries. Increased attention on growing income inequality in the nation and public outrage regarding banking CEOs bonuses after the housing bubble burst spurred legislators to try to cap growing executive pay. As seen in the graph below, CEO compensation compared to median wages has followed a trend similar to increasing wealth disparity in the country, more specifically, rising CEO compensation has closely followed rising income inequality in the nation.

Figure 4: Ratio of CEO Pay to Average Worker Pay, 1965-2004



Notes: Average worker compensation is calculated by multiplying the average hourly earnings of production non-supervisory workers times 2,080 and then multiplying this figure by the ratio of compensation to wages for 2003 – the last year for which data are available – for private industries. Data prior to 2004 are taken from L. Mishel, J. Bernstein, and S. Allegretto, *The State of Working America 2004/2005*, Ithaca, NY: Cornell University Press. Data for 2004 are from the Wall Street Journal, CEO Compensation Survey, April, 11, 2005, and from the Bureau of Labor Statistics, *Average Hourly Earnings of Production Non-Supervisory Workers*, Washington, D.C.: BLS, [www.bls.gov](http://www.bls.gov).

Source: Center for American Progress

The implementation of ‘say-on-pay’ on executive compensation extends democratic practices to corporations by promoting a culture of awareness, education, and action available for individuals concerned with CEO pay. By mandating that pay information be publicized, all individuals are able to involve themselves in corporate politics if they so wish. Further, shareholders’ voices are amplified in the realization that they can issue a nonbinding vote regarding corporate pay. The legislation does not dictate that shareholders have the ability to decide how much executives are paid; but rather, shareholders can publicly voice their opinions about payment packages; compensation will still be determined by independent committees. Although it is democratically progressive to strengthen transparency and increase the public’s voice, the ‘say-on-pay’ policy may fall short in actuality. ‘Say-on-pay’ gives shareholders a platform to voice their opinions about executive salaries and represents a transfer of power from a financial elite to individuals that can hold previously untouchable members of this elite accountable for their actions. This has the potential to diminish a growing wealth gap by limiting the top’s wealth and power.

A case study of JPMorgan Chase’s CEO’s compensation since the financial crisis provides an example of why the public was outraged at executive compensation rates and how the Dodd-Frank Act has dealt with increasing income disparity because of growing CEO pay. During the Great Recession, Chase’s CEO, Jamie Morgan, saw an increase in his salary. From 2009 to 2010, his compensation increased by 1,500%. In 2010, Dimon took home \$20.8 million worth of cash and stock options earning him 6<sup>th</sup> place in CNN Money’s biggest CEO pay raises list for the year 2010 (CNNMoney, 2011). Citizens were outraged that even during a recession and after receiving federal bailout money and loans in the 2008 financial crisis, Dimon was

rewarded. Further, Dimon's pay increased in 2010, despite that Chase's market value dropped by 23% in that same year (Cox, 2011).

An article in the Act's 'say-on-pay' prohibits executive compensation increases in times of business downturns. Legislation says that pay cannot encourage inappropriate risks and mandates that executive compensation be reflective of the company's financial performance. However, in light of Chase's \$2 billion loss in derivative trades in 2012 one day and the subsequent board decision a few days later, Dimon's pay increase demonstrates a blatant disavowal of what the Dodd-Frank Act's intentions were. Days after the billion dollar loss, shareholders participated in a nonbinding vote on executive decisions. Despite their increased power due to the Dodd-Frank Act, shareholders did not express discontent with the \$2 billion loss or Dimon's leadership even though it is clear that Chase is still engaging in potentially dangerous derivatives trading. Shareholders voted to keep Dimon as Chase's board's independent chairman in addition to his duties as CEO (Kim, ABC, 2012). This past shareholder's meeting did not address Dimon's pay. However, at last year's shareholder meeting, Dimon was "one of the few CEOs of U.S. banks who did not take a pay cut" (Kim, ABC, 2012). Despite the implementation of the Dodd-Frank Act and the increased power shareholders have received in executive decisions through it, the average shareholder and average American citizen appear to have gained nothing from 'say-on-pay.'

Similarly, business at Citigroup has not changed due to 'say-on-pay.' The CEO of Citigroup received a raise from 2010 to 2011 even though Citigroup's performance did not improve, violating the section of the Dodd-Frank Act that stipulates that executive pay must reflect business performance. Due to the introduction of 'say-on-pay,' at the Citigroup shareholder's meeting, the public voiced their discontent. For the first time in big bank history,

shareholders rejected compensation plans. However, due to the nonbinding nature of ‘say-on-pay,’ the Citigroup’s board does not necessarily have to, and didn’t, follow through with the will of their shareholders and carried out their intended compensation packages (Stemple, Reuters, 2012).

This suggests that ‘say-on-pay’ encourages a democratic culture where individuals know that they have the right to involve themselves in corporate behavior. Concerned citizens have joined various banking shareholder meetings knowing that they are welcome to voice their opinions. Unfortunately, public voice alone has increased and the execution of regulatory enforcement regarding executive compensation remains lacking. Regulators have seemingly forfeited their oversight to the public and have not reprimanded executives for their increasing pay even during times of business downturn.

### **The Volcker Rule**

A pivotal and highly contentious piece of legislation within the Dodd-Frank Act is the Volcker Rule. Nicknamed ‘the Glass-Steagall Act in spirit,’ the legislation aims to stop proprietary trading, or stop banks from speculating in the financial market with deposited money. The Volcker Rule is different from the Glass-Steagall Act in that its stipulations are not as strict as the legislation passed after the Great Depression. Whereas the Glass-Steagall Act sought to entirely end proprietary trading, the Volcker Rule states that proprietary trading can be used to an extent as long as regulators believe that banks are not utilizing proprietary trading riskily for the sake of increasing profit. The Volcker Rule was pioneered by a former head of the Federal Reserve, Paul Volcker, who states that the use of proprietary trading mitigates the purpose of banks within society and that proprietary trading encourages a culture that promotes risk taking.

During the financial crisis, banks engaged in proprietary trading when they used customer deposited money to speculate within the financial market to hedge against credit default swaps. Proprietary trading does not benefit banking customers, but rather provides an additional avenue for traders, executives, and shareholders to make more money. Volcker critiques proprietary trading because “it’s not part of the essential public purpose of banks for which they are protected by the government” (Volcker, Moyers, 2012). Volcker finds a fundamental flaw in how proprietary trading operates because he says that today banks are “effectively subsidized” since consumer deposits are protected by the federal government (Volcker, Moyers, 2012). Proprietary trading allows space for a conflict of interest to arise where banks may choose to make money at the expense of protecting its customers’ deposits. Proprietary trading is riskless for banks because banks’ deposits are protected by the FDIC. Thus, if banks lose money while speculating with customers’ deposited money, the government will reimburse banks with the deposited money that they lost with the interest of protecting bank customers. However, in this way, banks manipulate federal policies that were written to protect customer deposits in their own favor to encourage risky trading (Volcker, Moyers, 2012).

Not only did commercial banks like Chase and Washington Mutual utilize proprietary trading to profit during the housing bubble, but investment banks like Goldman Sachs and Morgan Stanley took advantage of proprietary trading policies after the financial crisis. Advice from the Federal Reserve encouraged the federal government to extend federal bailout money to banks that engaged in proprietary trading: the Federal Reserve contended that proprietary trading is an integral part to market-making. Proponents of proprietary trading said that proprietary trading enhances market growth because it is necessary for banks to invest in stocks and bonds so that they may later sell them to clients. Because of such recommendations, the government

allowed investment banks the ability to become commercial banks in an attempt to save the economy from further demise and investment banks then eagerly opened up commercial banking sectors so as to be able to receive government aid. As a result, nearly all banks profited from government subsidies and profit from the increased revenue available from proprietary trading and are joined in the fight to overturn the Volcker Rule (Volcker, Moyers, 2012).

Implementation of the Volcker Rule is lacking. Although the Dodd-Frank Act passed in 2010, the implementation date of the Volcker Rule is July 2012 and the Federal Reserve has further granted grace period of two years, until July 2014, before regulators begin reprimanding banks for proprietary trading. Delay in the implementation of the Volcker Rule results in legislators continued inability to finish the Rule: there is still no complete consensus of what the piece of legislation entails and how it is supposed to be enforced. Five federal regulatory agencies are now in charge of drafting the policy, the Federal Reserve Board, the Securities and Exchange Commission (SEC), the Federal Deposit Insurance Corporation (FDIC), the U.S. Department of Treasury's Office of the Comptroller of the Currency (OCC), and the Commodity Futures Trading Commission (CFTC) (Katz, Bloomberg, 2012). These regulators also determine how the Volcker Act differentiates from the repealed Glass-Steagall Act in that they have the final say in what fair proprietary trading is. According to the Volcker Rule today, regulators will allow proprietary trading if banks use it to buy or sell stocks, bonds, and derivatives in a way that either hedges against risk, or encourages the growth of healthy markets. But, regulators will reprimand banks if they deem their usage of proprietary trading to simply encourage banking profits (New York Times, 2011). Regulators have the final say in what the legislation will say and how it will be implemented, suggesting the critical role of effective monitoring to the success of the Volcker Rule once it is implemented.



Implementation has been prolonged and debate contentious because the Volcker Rule wishes to change a large part of the financial market where a lot of players have a lot of money at stake with a single piece of legislation. Once the Glass-Steagall Act was overturned in 1999 with the Gramm-Leach-Bliley Act, banks began to greatly profit from proprietary trading (Volcker, Moyers, 2012). As a result, the nation's largest banks, which all engage in proprietary trading because of the bailout package, have joined arms against the Volcker Rule. Since the introduction of the Dodd-Frank Act and the impending end of proprietary trading, "one Senator alone has received \$3.6 million from the financial industry" with the intent to dilute the Volcker Rule (Moyers, Moyers, 2012).

However, the big banks that profited off of proprietary trading even during the Great Recession are not the only ones to lose from the end of proprietary trading, furthering complications in drafting the legislation. Regulators have received concerns from abroad because many foreign investors have placed assets in banks that utilize proprietary trading and foreigners are concerned that the implementation of the Volcker Rule will reduce their gains. As a result, regulators are concerned that foreigners will stand by their threats and withdraw their money from American banks and place it elsewhere (Interview, Wedbush, 2012). Further, the end of proprietary trading for all banks includes the end of proprietary trading for small banks, which limits the opportunity for these smaller banks to compete against the national giants (Interview, Wedbush, 2012).

Despite the Volcker Rules extensive list of adversaries, Paul Volcker is optimistic that the Rule will be enforced in 2015 and that it "can be reasonably followed by the banks and regulated by the regulators" (Volcker, Moyers, 2012). Volcker says that his rule has the support of the community and small banks behind him. However, that Paul Volcker states that small banks

eagerly support the Volcker Rule, while the president of one of these small banks, Wedbush Securities, states concern for the impending end of proprietary trading suggests an indefinite political war where all players continue to place their best interests first at the expense of the actualization of the Volcker Rule.

### **Regulating the Federal Reserve and Preventing ‘Too Big to Fail’**

To enhance transparency, the Dodd-Frank Act institutes policy changes that affect the Federal Reserve. The Act mandates that the Federal Reserve disclose information about its lending practices to Wall Street businesses during the financial collapse. Due to perceived abuse of the Federal Reserve’s power, new legislation further introduces rules that limit the Federal Reserve’s ability to loan money under unusual and exigent circumstances. In an attempt to limit the Federal Reserve’s power, the Dodd-Frank Act also requires that the Treasury Secretary play a larger role in the Fed’s decisions.

Paul Volcker, a former head of the Federal Reserve, is optimistic about the Dodd-Frank Act and the idea that the government will no longer be able to bail out businesses that are ‘too big to fail’. A section of the Act says that neither the Federal Reserve nor the FDIC can rescue failing banks. The Act suggests that if a bank were to go under, the bank will ultimately have to be liquidated. Only customer deposits will be ensured and stockholders, management, and creditors will not be able to receive government money. However, due to the powers that be, it is debatable whether the enforcement and economics of the provision will hold true in actuality (Volcker, Moyers, 2012).

Prior to the implementation of the Dodd-Frank Act, the Fed had the power to extend loans to any individuals, partnerships, or corporations that are not depository institutions. This

provided a cause for concern, as Edward Wedbush explained: “The Fed has the ability to violate the government’s own precepts if it does not disclose its actions. If financial openness and transparency are being preached, then the Fed should follow these same rules” (Interview, 2012). The Act now stipulates that the Federal Reserve can only extend credit in an attempt to protect taxpayers from losses, can only provide liquidity to institutions that aren’t failing, and that a “program with broad-based eligibility” be established before the credit is offered. These programs will of broad-based eligibility will only be created with the prior approval of the Treasury Secretary (New York Fed, 2011).

The Dodd-Frank Act gives the Treasury Secretary further power a part from being the pivotal force in establishing programs with broad-based eligibility that are necessary for the Fed to extend loans. The Act established that the Treasury Secretary head the Financial Stability Oversight Council, which regulates the nation’s biggest banks and can order struggling banks to dissolve in an ordered fashion (Bloomberg, 2011).

However, a problem arises in the Dodd-Frank Act’s attempt to minimize financial institutions’ power on the Fed by concentrating regulatory power in the hands of the Treasury Secretary. Today, the Treasury Secretary is headed by Timothy Geithner. Geithner has demonstrated a strong alliance with the nation’s largest financial institutions and I question his ability to objectively determine what is best for the nation as opposed what is best for his financial buddies. During the financial crisis, Geithner, who then headed the New York Fed, helped JPMorgan complete a financial sector takeover. JPMorgan absorbed the country’s largest commercial bank, Washington Mutual, and the investment bank Bear Stearns. Instead of allowing these bankrupt institutions to fail, Geithner enabled the further success of these institutions by extending \$29 billion of credit (Bloomberg, 2011).

An additional critique of the Dodd-Frank Act is that in July of 2010, at the time of its enactment, the legislation's authors did not know the extent of the relationship between the Federal Reserve and financial businesses. A condition of the Act is that the Federal Reserve disclose information regarding its emergency lending practices during the financial crisis. However, all of the Federal Reserve's emergency lending practices were not disclosed due to the legislative mandates of the Dodd-Frank Act. Rather, the Federal Reserve only partially publicized some of its practices in December of 2010 as a result of the Act. It was due to the aforementioned lawsuit filed by Bloomberg LP against the Federal Reserve and the nation's 6 largest banks in March of 2011 that the extent of the Federal Reserve's lending practices during the financial crisis became public. This demonstrates the Act's inability to regulate the Fed as well as enforce its stipulations.

### **Consumer Finance Protection Bureau**

The Consumer Financial Protection Bureau is the critical aspect of the Dodd-Frank Act that provides oversight to the country's financial sector. The CFPB ensures that lenders and brokers of mortgages comply with federal financial laws. The CFPB will review the books and records of thousands of U.S. mortgage lenders and brokers that aren't banks to "evaluate mortgage originators' policies and procedures, assess whether originators are in compliance with applicable laws, and identify risks to consumers throughout the mortgage origination process". The examination is comprehensive. The CFPB will evaluate initial advertisements, marketing practices, and closing practices to ensure that customers are not confused at the advantage of financial institutions (Dodd-Frank, 2011).

The new legislation started off on shaky footing as the CFPB received a lot of scrutiny as. Commentators tread towards the Bureau's potholes and brush over its accomplishments. For example, many critique Obama's decision to not appoint Elizabeth Warren to head the CFPB. Although the Consumer Finance Protection Bureau was largely Warren's brainchild.

Also, in 2011, the Bureau failed to protect American citizens' wealth from money hungry banks. Large banks such as JP Morgan Chase, Citibank, and Bank of America introduced new fees on their customers in the fall of 2011. These fees included more frequent and higher fees on checking accounts and debit cards. When customers, the public, and the president responded negatively towards the new fees, banks responded that increases in overdraft fees and flat fees on cards were necessary measures to buffer profit losses due to impending financial regulation legislation, such as the Dodd-Frank Act (O'Connor, 2011). However, the Consumer Finance Protection Bureau did not have any power to prevent bank customers from these fee hikes.

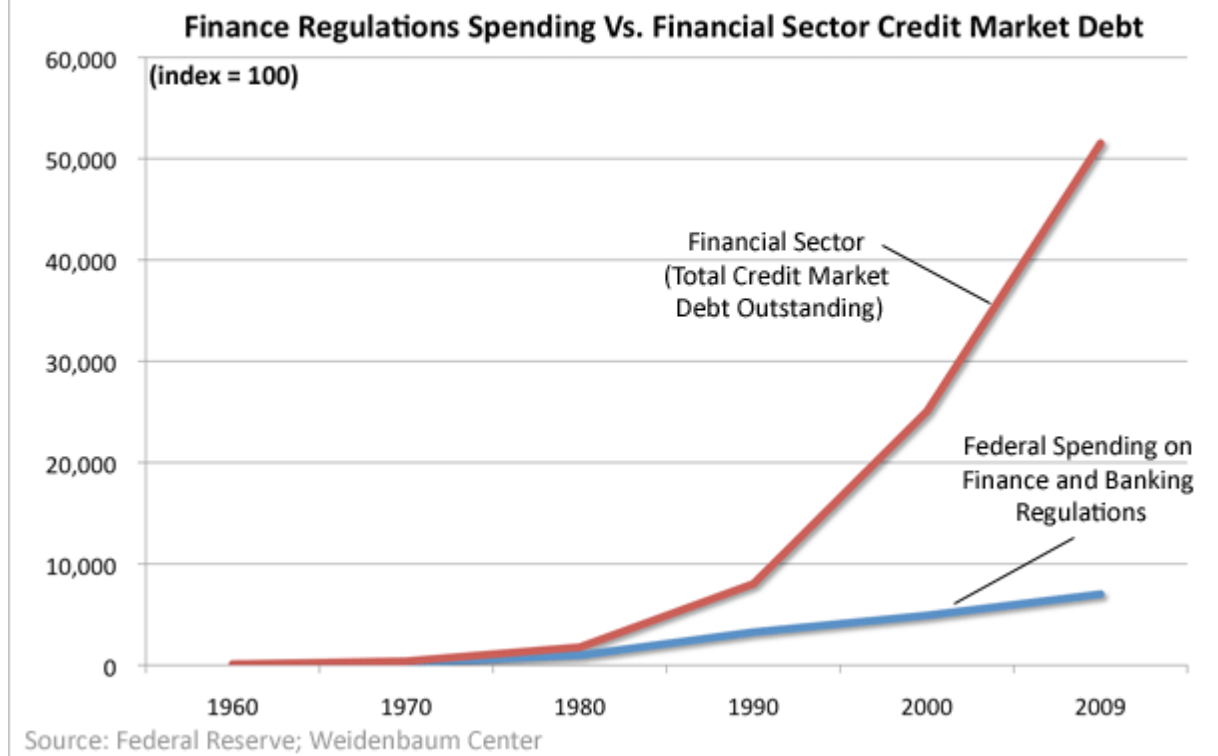
These fee increases demonstrate the need for financial consumer protection. Banks easily discriminate against less-affluent clients. For example, during the sub-prime mortgage crisis and foreclosure crisis, banks largely discriminated against ethnic minorities (Lee, Interview, 2012). The recent fee increases again demonstrate banks' ability and desire to discriminate against less-wealthy customers. The customers that complained most about the fee increases are those that are dependent on the money that they lost to the fee hikes. Apart from the desire to raise capital, banks dissuaded less-wealthy customers from banking with them because this practice makes economic while the wealthy provide the financial base needed for banks to conduct their day-to-day business, less wealthy customers may potentially pose a cost to banks (Eilers, Interview, 2012). This suggests that to either prevent such socio-economic predatory practices, even stricter regulation needs to be placed on banks that ensures banks do not discriminate against its less

affluent customers. Or, if a market approach is taken, perhaps this suggests that more banks need to emerge that cater to less-wealthy individuals

### **Financial Regulatory Enforcement is Not Keeping-Up**

Enforcement of the Dodd-Frank Act is dependent on a pre-existing financial regulatory institution. However, many of the organizations that it relies on are dated because they cannot keep up with the financial sector's growing pace. The financial market has been growing at exorbitant rates. The amount of outstanding credit that sustains the growing financial sector has quintupled in the past twenty years and the majority of this growth occurred in the past decade. Much of this growth can be attributed to the expanding derivatives market, which, as stated earlier, increased by 100% from 1998 to 2008 (Harring and Moses, 2008). Figure 3, below, demonstrates that financial sector regulation lags behind the growing financial sector and that the divergence has grown since the escalation of anti-regulatory ideology in politics that took hold in the 1980s. However, to not completely discredit the financial regulatory sector, the amount of money spent on financial regulation has also continuously increased since the 1980's, albeit, at a snail's pace in comparison to the growing financial market. This causes concerns regarding regulators ability to effectively oversee the financial sector and provides insight as to how regulators allowed for the financial crisis to transpire.

Figure 5



Source: Carney, John; Angelova, Kamelia. Business Insider. 2009. [http://articles.businessinsider.com/2009-09-28/wall\\_street/30001127\\_1\\_regulation-financial-sector-historical-trends](http://articles.businessinsider.com/2009-09-28/wall_street/30001127_1_regulation-financial-sector-historical-trends)

Even before the impending financial doom of the aughts, government financial regulation proved lackadaisical. I interviewed two employees about the three regulatory organizations that oversee Wedbush Securities. Of these three, the Federal Reserve is the only regulatory commission that the employees value. (This is not to suggest that the Federal Reserve does not have its own regulatory flaws.) They believe that the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Agency (FINRA) are inadequate in enforcing regulation due to the internal structures of the agencies.

The mission of the SEC is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation” (SEC, 2012). The SEC accomplishes its mission by

acting as a financial regulatory branch of the federal government and is crucial to the implementation and enforcement of rules within the Dodd-Frank Act. Samantha McAfee, who is in charge of assuring that Wedbush Securities is compliant with federal regulation, explained that even before the financial crisis, she was surprised with the SEC's inadequacy in regulating the financial sector at Wedbush Securities. She explained that in dealing with the SEC, she frequently found (and even today still finds) that the SEC is very inefficient in collecting data and enforcing banking regulations. She said that she is often beleaguered by employees from the SEC that call on her for repetitive information about the bank. In the interview, McAfee added that much of the information that SEC employees ask for is not even pertinent to the goal of overseeing that Wedbush's financial activities work within legal parameters. She attributes the lack of the SEC's ability to know what to ask for and how to ask for it, not to inefficient bureaucracy, but, to the young, inexperienced, and transient workforce that make-up the SEC. McAfee admits that she believes that she is more proficient in undertaking SEC responsibilities than the recent college graduates that she frequently interacts with (Interview, 2012). This demonstrates the government's inability to regulate the growing financial sector and, that for the most part, the only individuals that understand how this sector operates are those that are directly employed by investment banks.

Lawrence Manners, a financial advisor at Wedbush asserted that the Financial Industry Regulatory Agency (FINRA), another regulatory organization that monitors Wedbush Securities, "is a joke". FINRA is the largest independent regulator of American finance firms and seeks to protect investors and ensure market honesty. FINRA's business model is critiqued as being illegitimate because the survival of the regulatory agency is dependent on the fines that it amasses. And FINRA is therefore accused of collecting yearly profit that ranges of \$45 to \$85



from fines without effectively regulating or providing constructive criticism to the businesses that it oversees. Manners says that frequently after FINRA issues fines to Wedbush Securities, for example, FINRA does not provide Wedbush with constructive criticism of how the financial business can improve its operational procedures to be in better compliance with regulatory codes.

Apart from their internal flaws that prevent FINRA and the SEC from being effective regulating agencies, FINRA and the SEC have been corrupted by the desire to appease the most profitable businesses that they regulate. Bill Singer, a regulatory advocate, says in Forbes Magazine that FINRA and the SEC are biased in how they regulate and favor the interests of the wealthier organizations that they oversee. For example, Singer commented on internal contradictions within FINRA that allow big, profitable businesses to have a lot of emphasis on the direction of the agency. He elaborates that although small firms make up 90% of FINRA's member firms, they are given only 14% of Board representation, which is the same amount of representation the .03% of large firms have on the board.<sup>10</sup> Singer says the result of this division of Board representation suggests that FINRA caters to the largest firms. In fact, Singer says that "the FINRA Board is now a gerrymandered disgrace of 22 members" (Singer, Forbes, 2011).

Political games and payoffs may have attributed to how financial regulatory agencies addressed Wall Street businesses after the financial crisis. Jeffery Sachs explains that after the financial crisis, the SEC similarly proved inept in regulating the financial sector. Sachs exposed that banks nor their CEOs were reprimanded by the SEC after causing the nation's 2<sup>nd</sup> worst financial crisis, even though it was universally acknowledged that the housing bubble was the cause of the Great Recession. Sachs looks at the example of the world's largest financial services company, Citigroup (Sachs, TIME, 2011).

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<sup>10</sup> These are my own calculations that I conducted based on other data Singer mentioned in this speech.

The Dodd-Frank Act is heavily reliant on regulatory agencies to monitor financial activity and reprimand violations of the Act. For example, the Dodd-Frank Act is dependent on the SEC to implement 90 provisions and there are dozens of other provisions that are under SEC's authority (SEC, 2012). However, regulatory agencies are incapable of overseeing this sector. Employees that work for banks generally have much more sophisticated knowledge of the financial sector proving it easy for insiders to work outside of federal regulation. Further, assuming that regulators were perfectly prepared to effectively monitor the financial sector, they may not have the resources and capabilities to watch a sector that is growing at tremendous rates. However, regulating agencies are not perfectly prepared to provide for financial sector justice. These agencies have also been bought by the same financial money that has bought politicians to appease the wants of the financial market.

## **VIII. Recommendations**

### **Pass Effective Wealth Disparity Legislation**

Foremost, to enact effective rules that intend to diminish the growing wealth gap, policy makers and the public should be aware that income disparity and wealth disparity are distinct and entail distinct policy recommendations. Growing income and wealth disparity, although related, arise in different ways and need to be dealt with separately.<sup>11</sup>

Due to the correlation between income and wealth, depending on the policy, a reduction in income disparity may diminish wealth disparity. Legislation that limits income gain for the

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<sup>11</sup> I do not want to undermine the dangerous magnitude at which income inequality is also growing. Statistics from Saez and Picketty, two renowned academics that study economic disparity, demonstrate that from 2000 to 2007, incomes for the bottom 90% of earners in the United States rose by 4%, once adjusted for inflation, and incomes for the top .1% rose by 94% (Lowrey, New York Times, 2012).

rich can potentially limit wealth disparity. For example, the Buffett Rule, which is currently in debate within the Senate, can simultaneously diminish income and wealth disparity. The Rule calls for a minimum tax of 30% on those making over one million dollars, whether the income comes from salary, dividends, or capital gains. Such taxation may deter the wealthy from investing, thus limiting the amount of money that the wealthy make.

However, a reduction in income disparity does not always result in a reduction in wealth disparity. As previously mentioned, a European study demonstrated that countries with high redistributive taxes and generous federal transfer programs have low rates of income inequality, but not wealth inequality (Mueller et al, 2011).

Taxes on property and inheritance are taxes on wealth. Such policies can help reduce the wealth gap. However, these taxes just address wealth disparity in general as opposed to the causes of growing wealth disparity that were exposed in the financial crisis.

### **Enhance Effective Financial Sector Regulation**

Federal financial sector inefficiency played a large role in the financial crisis and rising wealth disparity. This lack of efficiency can be attributed to two factors. One is that financial regulators capacity to regulate a growing and constantly changing sector is potentially impossible. To deal with an imbalance of information between government regulators and financial moguls, the government has turned to the advice of individuals experienced in the financial world. This revolving door is problematic because individuals tied to financial businesses might hamper the ability to democratically resolve conflicts. This suggests a need to re-think who to appoint to monitor the financial sector, or perhaps even a need to re-think how the responsibility should be divided so that overseers may be held accountable. Also, there is a

lack of democratic practices within regulating organizations. Actions and regulation of the Federal Reserve, the SEC, and FINRA, strongly favor a financial elite at the detriment of the rest of the population's protection. Such problems may be absolved by decentralizing and depoliticizing regulatory agencies so that their power is strengthened. However, regulatory agencies will never be able to keep up with the growing financial sector. This suggests that more constraints should be put on financial growth so that regulatory powers as well as financial businesses grow at similar rates. In order to pass more financial sector regulation, a culture must be cultivated that understands the need of oversight and does not tremble at the mention of regulation.

### **The Role of Community Organizing in Diminishing the Wealth Gap**

Community organizing develops social capital as well as strengthens democracy by encouraging the participation of the less-powerful and less-wealthy in politics and policy-shaping. This is a form of grassroots political mobilization that engages individuals in issues that they care about and are effected by. Community organizing has three main principles: "to win real, immediate, concrete improvements in peoples' lives, give people a sense of their own power, and alter the relations of power" (Bobo, 2010, 9). In the wake of the financial crisis and the subsequent surge in wealth disparity, such mobilization has already begun. In the face of the populous' diminishing role in American democracy, community organizing plays a pivotal role in revitalizing the American public's dying political voice.

The Occupy movement presents an example of grass roots mobilization to further the causes of marginalized populations. By demonstrating publicly, the Occupy movement has had

the prolific effect of exposing the entire nation on issues related to increasing disparity, the involvement of corporations in politics, and the falling political power of Americans.

Move to Amend is one example of a community organization that has joined the ranks with many others in the Occupy movement. Move to Amend is engaged in grassroots, bottom-up organizing in an attempt to introduce a new amendment to the Constitution with the belief that many of the “problem[s] faced by citizens as well as directors and stockholders of corporations [are] systemic and rooted in how corporations are defined under the law” (Hartmann et al, 2011). Move to Amend’s proposes a 28<sup>th</sup> Amendment to the Constitution be adopted that explicitly states that a corporation is not a person and that it can be regulated by Federal, State, and local law. The Amendment also introduces legislation that money, such as political action committee (PAC) money, can be regulated, limited, prohibited, and publicized during campaigns (Move to Amend, 2012). PACs are affiliates with corporations that are allowed to donate an unlimited amount of money to political candidates and by limiting PAC money, the voices of the larger population as opposed to the money of the wealthy are more likely to be heard by politicians.

Move to Amend has had resolutions and ballot initiatives passed across the country where municipalities have acceded with the idea of eliminating corporate personhood. In December 2011, Los Angeles City Council signed-on to end corporate personhood. Move to Amend organized 500-600 individuals to demonstrate their allegiance to the cause. Similarly, New York City has agreed to the cause of eliminating corporate personhood (Lee, Interview, 2012). However, further mobilization is needed to spread awareness and solidarity in such movements that hope to minimize growing inequality. The Los Angeles representative of Move to Amend was quick to suggest that although eliminating corporate personhood was not the end-all-be-all to mitigate financial sector corruption, it is a start.

The Occupy movement has fizzled, but has yet to die. After Occupy encampments were evacuated across the nation, the Occupy movement has continued organizing. Occupy has further organized a national campaign called Bank Transfer Day where the movement encouraged bank customers to transfer their money from large commercial banks, like Chase, and put them in local banks and credit unions. This is a form of conscious consumerism where customers have the ability to promote smaller businesses while simultaneously attempting to disempower larger businesses by taking their banking elsewhere. However, it will not drastically disempower large commercial banks since banks are not reliant on lower class or even middle-class wealth to keep the banks afloat; rather, commercial banks want the businesses of the United States' most wealthy. Nonetheless, a transfer of bank accounts helps the survival of smaller businesses, which are crucial to a thriving and just economy. this is a progressive example of organizing, for Americans foremost are their money and consumer power and. The Occupy movement has fragmented and there are now spinoff actors like Occupy the Ports, Occupy Congress, and Move to Amend.

### **Increase Financial Literacy**

The Consumer Finance Protection Bureau is providing a valuable asset to the nation in providing financial education and acting as a watchdog of the banking sector. However, I posit that becoming financially literate is crucial enough to survive in the United States that subjects on the topic should be taught in high school. Understanding how to open a bank account and take out a mortgage are arguably even more practical than fulfilling a foreign language requirement or learning Geometry. If classes such as health and fitness are mandated for high school students to attend, then, at the least, there should be a financial literacy elective offered to future generations

of Americans. If the finance learning curve diminished, then the C.F.P.B. would then be able to focus their resources on better regulating the banking sector instead of also educating citizens on the significance of menial banking interest rates.

### **Get Money Out of Politics**

The idea of getting rid of money's prevailing presence in politics is daunting. However, baby steps that regulate the influences surrounding how politicians and political agencies conduct business may prove fruitful. For example, due to increasing public outrage regarding inequality and money's influence in politics, earlier this year, Congress passed legislation to prohibit Congress' ability to make insider trades (Pear, NYT, 2012). This suggests that before 2012, Congressmen were legally able to profit from the stock market with insider information – an act illegal in another sphere of American society.

### **IX. Conclusion**

Populations across the globe have joined in solidarity to demonstrate against increasing economic disparity. In the past year alone, protests have erupted in every continent demanding a redistribution of resources and the implementation of justice due to perceived inequity inflicted upon the masses by the elite. These social uprisings have demonstrated the centrality of inequality to global citizens' fundamental beliefs of what a government's responsibilities are to its citizens and that humans have shared responsibilities to ensure that a rising tide lifts all boats.

Although general perceptions of the implications of increasing economic disparity remain hotly politicized and theoretical, the explicit correlation between increasing wealth disparity and

increasing financial sector power seen during the 2008 financial crisis suggests that a financial elite will continue to amass power and wealth if the sector is not effectively regulated. In light of the series of major financial blunders committed in the United States seen since the collapse of the housing market in 2008 (the bankruptcy of MF Global, a major global derivatives broker, in late 2011 due to bad bets on European debt, and JPMorgan Chase's \$2 billion loss in May of 2012 due to risky derivatives trading on European debt), it is evident that the financial sector continues to engage in risky activities, regulators remain incapable of monitoring the financial sector, and governments maintain apathetic in reprimanding (Silver, NYT, 2012). If left unchanged, today's growing unregulated financial market remains perilous to the larger social, political, and economic contexts within it stands.

Growing wealth disparity proves to be detrimental to all aspects of society. Although increasing wealth disparity can push many into poverty, as was seen in the Great Recession, it can also unleash social unrest, disrupt the economy if it expands greatly without regulation, limit meritocracy since growth and favorable rules are relegated to the wealthy, and promote a culture of mindless capitalism. Blind consumption seeks to view all objects in the world, including humans, as objects of which to extract value. Capitalistic drive has caused humans to succumb to the goal of amassing as much power and money as possible and this drive has partially led individuals to unabashedly seek their own profit without regard of the consequences. The public should keep in mind that our modern era is based on the proliferation of individuals that seek to source increasing power from the resources around them and this does not exclude the government and individuals within it. As society continues to address questions surrounding increasing disparity, discourse should also address the negative consequences of mass and intense consumerism.



The basis of popular culture today is centered on themes that address inequality ranging from top-selling literature and films including “Avatar”, “The Help”, and “The Hunger Games”. This suggests the popular desire to address increasing disparity and that a dialogue centered on inequality will flourish within the United States, the cities within it, and the larger context that the nation is a part of. This paper has been an appeal to all readers to question what is given to American citizens as known, and seek answers as to how individuals can engage in inciting change. At the least, as Lee said, citizens must “keep our angry-up” as a duty if individuals seek to slide increased power from the elite that rules to the portion of the population that is governed. And a critical issue that all levels of society can mobilize around to preserve the United State’s demising democracy.

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## Appendix

### 1. Wealth Division in Europe

#### Share of Total Net Worth of 15 European Countries

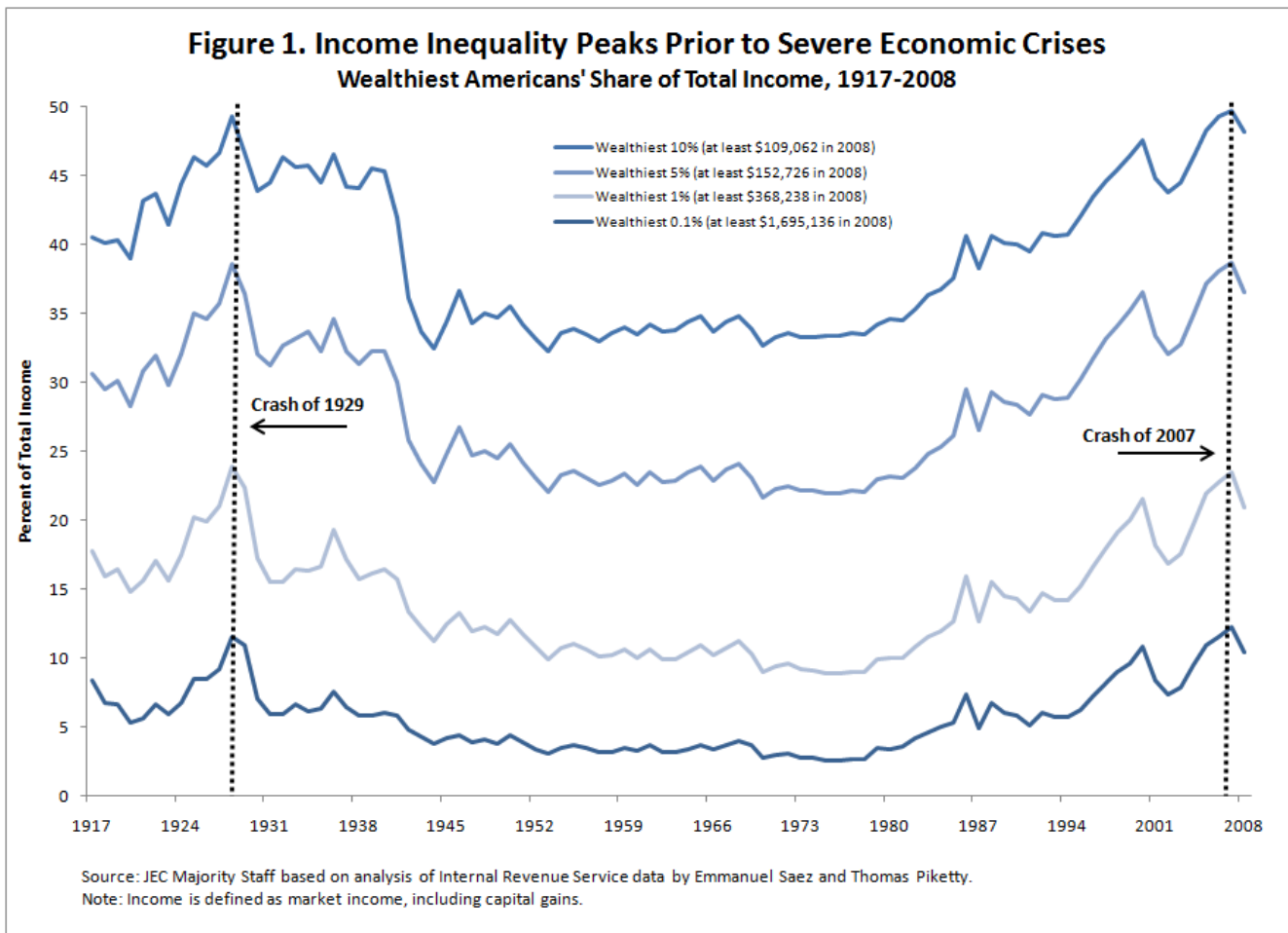
(Organized by the country with the most wealth concentrated in the hands of the top 5%)

Country	Total Net Worth	Bottom 20%	Bottom 50%	Bottom 90%	Top 10%	Top 5%	p90/50	p90/10
PL	173,253	0%	6%	38%	62%	53%	4	*
NL	673,711	0%	8%	46%	54%	42%	4	312
CH	492,572	-1%	7%	46%	54%	42%	4	98
SE	559,414	0%	8%	49%	51%	37%	7	203
FR	790,734	0%	11%	53%	47%	36%	3	407
DK	527,391	0%	9%	55%	45%	32%	4	500
ES	484,542	0%	14%	58%	42%	31%	3	17
DE	401,366	0%	9%	57%	43%	30%	4	270
GR	496,518	1%	14%	58%	42%	29%	4	38
IT	536,794	1%	14%	61%	39%	27%	3	286
AT	181,646	0%	11%	62%	38%	26%	3	186
BE	694,053	1%	17%	65%	37%	24%	3	54
CZ	198,237	0%	14%	66%	34%	21%	3	*

Source: Mueller, 2011, 14

### 2. Income Inequality and Economic Effects

There is a current dialogue regarding income inequality and economic growth. For example the U.S. Congress Joint Economic Committee finds a correlation between income inequality and recessions. They say that in 1928, at the peak of the stock market bubble, the top decile controlled 49.3% of the nation's total income. In 2007, on the eve of the Great Recession, the wealthiest decile controlled 49.7% of total income (2010).



Further, the World Bank 2006 World Development Report says “We now have considerable evidence that equity is also instrumental to the pursuit of long-term prosperity in aggregate terms for society as whole.”

### 3. A Selection of the Interview Questions I Utilized

- What do you think are the causes of the financial crisis in the United States?
- A lot of attention has been given to derivative trading, how recent of a phenomenon is derivative trading?
- Why are the wealthy more likely to own financial wealth?
- What do you think are the causes of the increasing wealth disparity in the United States?
- What do you think are the consequences of increasing disparity?
- Do you think that the financial sector should be more regulated?
- What do you think about the Dodd-Frank Act?

- What are past policies that either diminished or exacerbated wealth disparity?
- Why has the topic of economic disparity been forgotten for 80 years?
- Do you think that the government has a responsibility to limit the growth of wealth disparity?
- What do you think are consequences of growing wealth disparity/ why should people care?

4. Another national response to the financial crisis and rising wealth disparity is the Occupy movement. Two weeks after the initial camp-out in New York City, Occupy Wall Street publicly posted their list of demands for Congress. There are various claims online as to what Occupy Wall Street's demand are. I'm using the first publicly listed OWS demand that can be found on the 'forum' section of the Occupy Wall Street's webpage. The following are Occupy Wall Street's seven demands:

1. Investigate, arrest and try the Wall Street criminals who clearly broke the law and helped cause the 2008 financial crisis
2. Reverse the effects of the Citizens United Supreme Court Decision (This was a Supreme Court decision made in 2010 that allowed for corporations to have the same rights as people and that includes being able to donate to political campaigns.)
3. Re-instate the Glass-Steagall Act of 1933
4. Close tax loop holes for corporations and pass the Buffett rule on fair taxation
5. Re-create the Securities and Exchange Commission
6. Establish free public airwaves for presidential candidates during campaign season
7. Reduce the power of the military-industrial complex by effectively building a wall nse industry and the U.S. military to prevent corruption

## 5. Derivatives Explanation

Derivative contracts have been used for millennia because they offer more financial opportunities for buyers and sellers that otherwise would not exist. For example, if you want to guarantee that you will be able to eat organic strawberries in the summer (because the thought of pesticide-ridden and genetically modified strawberries that were unsustainably produced or transported grosses you out), you can purchase a derivative for 5 pounds of local organic strawberries to be delivered to you by mid-July. These strawberries have yet to be harvested and since you already paid in full for your strawberries, you run the risk of paying for something that doesn't exist yet. But, luckily, the purchase of your derivative helps insure that an organic strawberry farmer will produce 5 pounds of organic strawberries just for you. In the case that the farmer defaults on the deal and is unable to own-up to his end of the deal, you, the buyer will be guaranteed reimbursement of your initial payment. Such uses of derivatives have been utilized since the time of Christ and have greatly contributed to humanity's ability to trade and produce.