



The Financial Playing Field

In November of 1999, the U.S. Congress passed legislation that dramatically changed the rules of the game for American financial institutions, effectively repealing many of the regulations set up in the aftermath of the financial crises of the Depression era. The Gramm-Leach-Bliley Act (officially called the Financial Modernization Act of 1999) capped nearly two decades of financial and monetary deregulation in the United States. It's too soon to judge the overall impact of the changes. However, the removal of regulations raises questions about stability in the financial sector and the declining role of financial institutions in meeting the needs of ordinary households and communities.

What does the Gramm-Leach-Bliley Act actually do? First, it removes the barriers to ownership within the financial sector that were set up following the crises of the Depression years (these regulations were originally adopted under the [Glass-Steagall Act](#)). This means that banks can own insurance companies and [securities](#) corporations – that is, firms dealing in stocks and bonds. Large conglomerates, called [Financial Holding Companies](#) or FHCs, that were once illegal, can now establish themselves. Second, the Act adopts a new regulatory structure for the financial sector. The FHCs will now be allowed to pursue a number of activities without need-

ing to seek approval from a regulatory body. Furthermore, banks within an FHC can conduct many securities transactions outside of the scope of existing securities laws. Finally, the Act weakens the [Community Reinvestment Act](#) that aimed to insure that financial activities had real benefits to communities across the country.

Financial deregulation harbors several potential dangers. First and foremost is a heightened risk of financial crisis. As barriers between financial activities are demolished, the chance of a crisis in one part of the financial sector spreading rapidly to other areas increases. Fewer safeguards mean more risks. Often financial crises require billion dollar bailouts to clean up the mess (think about the Savings and Loan crisis of the 1980s) – public funds that could be more productively used elsewhere to revitalize poor neighborhoods, fix problems with the healthcare system, or improve education.

This trend in financial deregulation could be seen as a signal to large financial conglomerates that they can abdicate without question any role they might have in community and social development. Many investments can have large social returns, but lower levels of private profitability. In essence, the regulatory changes make the financial playing field less equal. Big players are given more rights and

expanded influence, while smaller players are handicapped.

While the Gramm-Leach-Bliley Act is restricted to the U.S., its influence is global in scope.

Shifts in U.S. markets can have sizeable ripple effects in financial markets around the world. A crisis here could very easily trigger a global meltdown. In addition, one influential argument for adopting the provisions of the Gramm-Leach-Bliley Act was that the U.S. financial firms were hindered in their ability to compete with other corporations worldwide. Competitive pressures and an ideology of deregulation have made the playing field more unequal both in the U.S. and around the world.

What are the alternatives to a set of rules that create such large inequalities of power and influence in financial markets? First, the spirit of existing anti-trust laws could be incorporated into efforts to scrutinize the behavior of the emerging financial conglomerates and to monitor trends of concentrated ownership and monopoly-like influence. By limiting the size of financial corporations, the risks and costs of failure could be regulated. Second, monetary controls and policies aimed at limiting specu-

lative activities could reduce the dangers of crisis. Third, the financial sector should be modernized in a way that adopts *better* regulations, rather than simply eliminating out-of-date restrictions. For example,

activities within the financial sector could be separated in a way that makes sense. Plus, careful separations of financial activities could reduce risks without adopting a bureaucratic tangle of restrictions. Finally, the needs of households and communities could be given more, not less, voice in how the financial sector could function best.

Source:

Financial Markets Center. 1999. "Triumph of the suits." *FOMC Alert* 3(7-8).



The Center for Popular Economics is a non-profit collective of political economists that teaches economic literacy to activists for progressive social change. CPE creates and communicates economic theories that challenge systems of oppression based on class, race, gender and nation. Our programs and publications demystify economics and provide alternative to mainstream analyses.