Bankers Arouse Public Anger. But Will They Change?

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It's not easy being a banker these days.

In some European countries, they're the target of street demonstrators who blame them for the financial crisis and resulting government austerity plans. Britain raised its terror alert in September after Irish Republican Army dissidents threatened British bankers because of Ireland's woes. Now, British bankers worry their bonuses will stoke local public anger.

The mood's not much better on this side of the Atlantic, where commentators wonder how useful some banking really is. "What good is Wall Street?" asked a New Yorker magazine article, the second most-read story on its November website. Much is "socially worthless," concludes author John Cassidy, who has been making the rounds on radio talk shows.

Banking practices have also come under stinging attack from prominent economists and political scientists in the latest issue of *Daedalus*, a quarterly magazine of the American Academy of Arts and Sciences. The financial system can quietly distort the direction of the real economy, write Benjamin Friedman of Harvard University and Robert Solow of the Massachusetts Institute of Technology, both in Cambridge, Mass. "It can induce the real economy to spend human and material resources on activities that can lead to immense private profits for some of those engaged while nonetheless making little or no contribution to general well-being."

That's a sharp indictment. In the run-up to its near meltdown, the financial system operated with the benefit of top bankers too much in mind. They took enormous risks, borrowing as much as 25 to 30 times their own firm's basic capital to enhance profits. When the market turned and their gambles went terribly wrong, taxpayers had to commit their own money, and shareholders of investment banks like Bear Stearns and Lehman Brothers were largely decimated.

How did these bankers fare? The top five executives at Bear Stearns and Lehman made roughly $250 million apiece in sales of stock and bonuses in the 2000 to 2008 period, notes Harvard economist Lucian Bebchuk. There was no "claw back" provisions for these earnings. Even in 2009, the executives' bottom lines were "positive and substantial," he writes.

Governments have made some progress in discouraging extreme gambles by the financial community, says Jeremy Stein, another Harvard economist. The 26-nation Swiss-based Basel Committee on Banking Supervision, for instance, recently raised capital requirement standards for commercial banks from 2 percent to 7 percent by 2018. That's "a pretty positive step forward," Mr. Stein says in an interview. The Dodd-Frank Wall Street Reform and Consumer Protection Act also potentially strengthens traditional US banks.

"We are being attentive to big institutions," he says. But "a lot of stuff," including detailed regulations under the new law, have yet to be drawn up.

He's especially concerned that the "shadow banking system," consisting of many firms performing bank-like economic functions but without such protections as insured deposits or the right to borrow from the Federal Reserve, could suffer a crisis, say 10 years from now.

Will public anger impel more change? While receiving most of the votes of lower-income voters, the Democratic Party has come to rely more for campaign funds "on the financial resources of wealthier supporters and interest groups," write several political scientists in *Daedalus*. That may make further reform politically tougher.