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The Insurgents: The Secret Battle To Save Capitalism

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Maria Cantwell sat aghast in front of the TV in her Senate office last fall, watching Wall Street crash. Not long after her arrival in D.C. in 2001, Enron imploded. Energy speculators wielding complex derivatives had gouged her constituents in Washington state out of $1 billion. The federal government, she thought, had done little since then to prevent fraud and manipulation. So last September, after Fannie Mae and Freddie Mac nearly failed, Lehman Brothers went under and the stock market plummeted, she decided she'd had enough. "I have seen this movie, and I know how it turns out," Cantwell said.

Cantwell knew something about business—she had made millions as an executive at RealNetworks during the dotcom boom. And she was concerned that the administration, filled with men who had supported financial deregulation during the Clinton administration, didn't have the stomach to impose the kind of tough reform she thought Wall Street required. So, along with a small group of insurgent Democrats in the Senate, she began pushing for a meeting with President Obama to make her case.

Finally in late March, Cantwell and her confederates—Carl Levin of Michigan, Byron Dorgan of North Dakota, Dianne Feinstein of California, Jim Webb of Virginia and Vermont's Bernard Sanders—met with Obama and members of his economic team in the White House. "I told the president I was concerned that the administration had people in charge who had missed all this before," she says. It was an awkward moment: two of the officials that Cantwell and her allies came to complain about—Obama's chief economic adviser, Larry Summers, and Treasury Secretary Tim Geithner—were sitting right there.

Yet one by one, the other senators echoed Cantwell's concerns. Obama's appointed officials and nominees were products of the system that had brought us this economic grief; they would tinker but in the end leave Wall Street mostly intact. "Some of the people around the president needed to be given a push," says Levin.

For their part, administration officials reject this view. "Nobody has been more aggressive than Tim Geithner and Larry Summers on this issue," says Michael Barr, an assistant Treasury secretary working on regulatory issues. "From the start, they've been firm about the need for fundamental reform in the system." Summers acknowledges his views on regulation have evolved since the '90s, and he says the back and forth is helpful. "The president always wants access to the best thinking and widest range of views on any subject," Summers told NEWSWEEK.

The internecine war of wills between the insurgents and the White House economic team has occurred mostly out of sight. But it is part of a larger battle for the future of the financial system—and in some ways capitalism itself. At issue is whether the financial landscape—the size of Wall Street firms, who regulates them and the kinds of things they will be allowed to trade—will look much different once the crisis passes. These senators fear it won't unless they are vigilant.

The insurgents have their own agendas. Dorgan warned in 1999 that "massive taxpayer bailouts" would result from the repeal of the Glass-Steagall Act, a move that allowed investment and commercial banks to merge. Both Dorgan and Cantwell are worried about loopholes that will permit firms to keep trillions of dollars of derivative trades in the shadows, escaping regulation. Levin, for his part, wants to rescind many of the Clinton-era laws that led to deregulation, including the 2000 Commodity Futures Modernization Act, which exempted credit default swaps from regulation. Unless giant financial firms like Citigroup and AIG are broken up, Sanders says, they'll have to be bailed out again someday. Yet the six senators have united to play old-fashioned power politics: Cantwell and Sanders placed a hold on the nomination of Gary Gensler, the president's pick to chair the Commodity Futures Trading Commission. This was the key regulatory body that in 1998 had fought unsuccessfully under Brooksley Born to rein in derivatives trading. Born's efforts were beaten back by the Democratic administration under Bill Clinton, including Gensler, who as Treasury undersecretary had opposed regulation of credit default swaps. Those are the financial instruments that later brought AIG—and much of the financial system—to the brink of meltdown.

The Senate pressure seems to have paid off. In the last several weeks, Summers has engaged Cantwell in a series of phone calls about derivatives regulation. Cantwell and her supporters say that Summers listened to her eagerly and that the regulatory framework for derivatives laid out by Geithner a week after the calls bore her stamp. She was given assurances, for instance, that the administration would keep big firms from speculating by placing "aggregate," or total, limits on the derivative positions they could take.

Administration officials say they were already working on the changes, though Cantwell's advice was a valuable part of the process. This week, Geithner is expected to unveil his broadest proposals yet aimed at preventing interconnected financial firms from growing too big.

Even Gensler seems newly sympathetic to Cantwell and the insurgents. He says he is not opposed to tighter regulation. Gensler, a former Goldman Sachs executive, now concedes that he should have fought harder for aggressive regulation in the '90s. He also agrees that the dispute over his nomination probably pushed the administration to focus on regulation. Gensler described the senators who held up his nomination in diplomatic terms—Cantwell and Sanders finally let his confirmation vote go forward in May—as "allies in trying to bring reform to the over-the-counter derivatives marketplace."

Typically, Obama has also shown himself open to other views, and Levin and his allies say they believe the president is pushing his own economic team to crack down harder on Wall Street. "I think the president was always where we were on this issue," Levin says. (White House spokeswoman Jennifer Psaki says Obama gave a speech almost two years ago calling for major regulatory reform, and since he took office has "asked his economic team to seek input from all sides.") In late April, Obama gathered some of his chief outside economic critics—including two of the most vociferous, Nobelists Joseph Stiglitz and Paul Krugman—for a cozy dinner in the old family dining room of the

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White House. At one point during the two-hour meal, Stiglitz and Summers began arguing whether hedge funds might amass a windfall profit by purchasing the long-term bonds of bailed-out banks. Obama impatiently moved the discussion forward, saying the numbers weren't the point, solutions were, according to two participants who would relate the president's comments only on condition of anonymity.

Much remains unaddressed, say Cantwell and other critics. Now that the financial markets are beginning to stabilize and the big Wall Street players pledge to pay back their bailout billions, they are digging in against fundamental change. Recently, a group of big banks including Citigroup, JPMorgan and Goldman Sachs formed a new lobby to fight controls on over-the-counter derivatives. Cantwell is skeptical that the Obama team will hold the line against the Wall Street lobby. "Do I think they've become true believers? No, I don't." She says Gensler is already "whining" about how hard it is going to be to get new regulation past Wall Street. Gensler insists he and the Obama administration are determined to rein in the financial industry once and for all. "We need to regulate all derivatives, standard or customized, by regulating the dealers," he said. Gensler is clearly under a lot of pressure. The question is, who is he more worried about: Wall Street or fellow Democrats like Maria Cantwell?

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