The visible hand

April 28 2011, By Peter Dizikes

The recent banking crisis represented a missed opportunity for the U.S. government to put financial markets on a firmer foundation and prevent future meltdowns, former New York governor Eliot Spitzer asserted in a talk at MIT on Tuesday.

“At the moment of the economic cataclysm,” Spitzer said — referring to the financial sector freeze-up that began in fall 2008 — “I thought, ‘We will finally have that epiphany that will bring us back, we will embrace rational policy once again.’ And here we are two years later, and I’m thinking: ‘What happened? How can this possibly be? Didn’t people learn a lesson?’ ... I’m afraid to say the answer is no, they didn’t.”

Speaking in a full Wong Auditorium, Spitzer suggested that Congress' efforts at financial reform have not brought about substantive changes to the financial industry. That inertia has left the economy "on the precipice" and at risk of similar downturns in the future, Spitzer said, while maintaining a dangerous level of income inequality in the United States. The talk, "Government's Place in the Market," was part of a series of "Ideas Matter" forums, presented by *Boston Review* and the MIT Department of Political Science.

Three reasons for government to get involved

In his remarks, Spitzer outlined three main reasons why government is necessary to keep markets competitive and fair. First, he offered, "Only government can enforce rules of integrity, transparency and fair dealing in the marketplace. Private-sector companies simply can't do it." As an example, Spitzer cited his own experience as New York attorney general, prosecuting investment-bank analysts who promoted dot-com businesses, effectively helping the banks make money by underwriting initial public offerings of those firms' stocks.

During the more recent collapsing bubble, tied to the collapse of the subprime-mortgage market, Spitzer noted that some investment banks were selling securities based on subprime mortgages to clients while privately betting that those securities would fall.

Second, normal economic actions produce "negative externalities," or costs imposed on those not responsible for the activity, Spitzer observed. For instance, pollution from powerplants can move across state lines, creating health and economic costs for those far away from the source of pollution. "Only government can measure these negative externalities and try to impose behavior modification on the economic actors," Spitzer said.

Finally, Spitzer noted, “There are certain core values that pure unbridled market behavior does not respond to,” naming discrimination laws as an example of necessary government interventions.

Spitzer served as New York attorney general from 1998 until 2006, then as governor from January 2007 until resigning a year later.

Moving the debate

In making the case for the active hand of government, Spitzer acknowledged, he was moving against a tide of “anti-government venom” over the last 30 years. That sentiment, Spitzer said, has successfully created a “shifting of the political debate far to the right” that helped undercut momentum for more ambitious reforms following the market meltdown of 2008-09.

Spitzer was introduced by Simon Johnson, the Ronald A. Kurtz (1954) Professor of Entrepreneurship at the MIT Sloan School of Management, who has also become a vocal critic of the banking industry. Johnson began the question-and-answer session after Spitzer's remarks with his own question: “What should any one individual do? … As a regular person, what opportunities do they have and what should they prioritize?”

In response, Spitzer said, “The first thing we should do is demand a greater level of integrity in the substantive answers we’re getting from our elected officials,” saying that members of both political parties have whitewashed the serious economic problems the country faces. In lieu of strengthening regulatory bodies such as the Securities and Exchange Commission, Spitzer said, “We need to reinvigorate shareholder activism.”

Spitzer has written a short book, also called Government’s Place in the

Market, appearing this month as part of the Boston Review series published by MIT Press. This was the eighth and final "Ideas Matter" forum of the 2010-11 academic year. The event was taped for future airing on the cable network C-SPAN.

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Provided by Massachusetts Institute of Technology

Citation: The visible hand (2011, April 28) retrieved 25 April 2024 from https://phys.org/news/2011-04-visible.html

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