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Voices of Power: Elizabeth Warren

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LOIS ROMANO: Welcome, Elizabeth Warren, Chairman of the Congressional Oversight Committee that is tasked with scrutinizing how the Treasury Department has spent $700 billion to shore up our failing financial institutions. Thanks for joining us today.

ELIZABETH WARREN: Oh, it's a pleasure to be here.

ROMANO: So, the first thing I want to ask you is you are about to become a household name. You are-you are one of the heroines, you're being described of, of Michael Moore's new movie which derides capitalism and goes after our economic structures.

WARREN: Well, I'd have to say, you know, I did an interview with Michael Moore and now I'm just astonished. I never thought I would be in 9 million television commercials, so it's been pretty amazing.

ROMANO: There's a wonderful moment when he asks you where the $700 billion is, and you look at him and you say, "I don't know." So the question is: why don't you know?

WARREN: Well, we don't know where the $700 billion is because the system was initially designed to make sure that we didn't know.

When Secretary Paulson first put this money out into the banks, he didn't ask "what are you going to do with it?" He didn't put any restrictions on it. He didn't put any tabs on where it was going to go; in other words, he didn't ask. And if you don't ask, no one tells. And so we have a system that originally put more than $200 billion into the financial institutions basically saying just take it.

ROMANO: And that money is gone. You have not been able to track where that money is?

WARREN: Well, we don't know where the money went from the financial institutions.

The big conversation at the time was that the credit markets are frozen; if we put money into the financial institutions, they will start lending it because that's what they do when they receive money. And you may remember we tend to have forgotten what the name of the program was initially. It was called the "Healthy Banks Program," because the allegation was Secretary Paulson kept saying, over and over, these are investments in healthy financial institutions, no one needs any subsidy.

And so we put it in on the claim by Secretary Paulson that that money was going to be used in lending to small businesses and consumers and kind of get our whole credit market going again. That didn't happen.

ROMANO: Do you agree with Michael Moore's basic premise that capitalism as it is now has destroyed the country's middle class?

WARREN: Well, I believe that the middle class is under terrific assault. And I don't want to play this as a capitalism issue.

When we compare middle-class families today with their parents a generation ago ¿ we have basically flat earnings-a fully employed male today earns on average about $800 less, adjusted for inflation- than a fully employed male earned a generation ago. The only way that houses could increase or families could increase their household income was to put a second earner into the workforce, and, of course that's now flattened out because there aren't any more people to put into the workforce. So you've got, effectively, flat income in this time period ¿ with rising core expenses; housing; health insurance; child care; transportation, now that it takes two cars to get everywhere, two jobs to support; and taxes, because you've got two people in the workforce and we have a somewhat progressive taxation system. So that families are spending a lot more on what you describe as the basic nut.

The third leg to the triangle, and that is families, to deal with this, stopped saving and started going into debt.

And the debt side of where families both spend more money and are made much more vulnerable on mortgages, on credit cards, on check overdraft fees, all this side of it, the credit side of it really means that we have a middle class that a generation ago we would have described as solid, secure, dependable. If you could just get into the middle class, you could pretty much count on a fairly comfortable life and all the way through to a comfortable retirement.

That's been hollowed out. Sure, there are people who are going to make it through just fine, but the vulnerability of families in the middle class has just ¿ it has gone up enormously.

ROMANO: We're just past the year anniversary of the collapse of Lehman Brothers where a lot of safeguards were ostensibly put in place. The TARP money went out.

Are we, as an economic nation, are we better off systemically now? Have we put things in place to prevent this from happening?

WARREN: You know, this really has me worried. A year ago when we talked about why we needed to pass the TARP, why we needed a $700-billion blank check written to the Secretary of Treasury, remember what we were saying. We said the big crisis is toxic assets on the books of the banks.

Today, the banks still have those toxic assets. Almost none of the TARP money was used to remove the toxic assets. Some of it may have been used to write down the total amount. But, in the meantime, those toxic assets, many of them have gotten more toxic, more foreclosures, higher unemployment rate. Now we're starting to move into commercial mortgages creating problems. So the way we described the crisis a year ago is still a very serious crisis today.

A year ago, we talked about too big to fail, too much concentration of the banking industry and too deeply interwoven. A year later, the big are bigger than they were. They are more intertwined, and there's more concentration in the banking industry. The failures have all occurred among the intermediate-sized and smaller banks, so we have a more concentrated industry.

And then the ¿ kind of the third part of it, rolling forward just a little bit, our path out was going to be the stress tests. And so we had the announcement in February/March, we're going to do the stress tests, and then everyone passed the stress tests. But the Congressional Oversight Panel at the time, who was trying to review these stress tests, were very concerned about not seeing enough of the detail about how the stress tests had been implemented. They were only implemented on the 19 largest financial institutions.

ROMANO: So, was the government playing God? What gives the government the right to choose who is going to succeed and who fails?

WARREN: Well, I'm not sure if they're choosing who succeeds and who fails so much as they have concentrated their efforts on the very large financial institutions.

In effect, that means they've said to the rest of the financial institutions, you know, we can let you die. One can understand the reason for the policy, but it raises some very troubling aspects not only about choosing winners and losers. But overall about how we're going to try to rebuild our economy.

ROMANO: What I hear you saying is that we're still facing a fairly fragile economy.

WARREN: The way I see it is that the financial system itself is quite fragile, and the underlying economy, the real economy ¿ jobs, housing, household wealth ¿ is still in a very perilous state.

ROMANO: Today unemployment is up again. Are we facing a jobless recovery?

WARREN: I just don't think we could talk yet in terms of a recovery. I think the right way to understand this is that we stabilized the patient. No one goes to bed at night wondering when you wake up in the morning and will this financial system have collapsed.

We clearly are past that point, but we have to remember the way we stabilized it. We stabilized it by saying the American government is going to put its money, its guarantees, the taxpayers' money behind our financial system to hold it up.

And that may have given, you know, some cheery news to investors in the stock market who say I want to invest in some of those companies that have those sorts of government guarantees to back them up, but it doesn't tell us that the economy itself is turning around. It doesn't tell us that there are good jobs out there or even that we're starting to build the infrastructure that's going to produce those good jobs.

ROMANO: I was reading a transcript of a hearing that you conducted with Secretary Geithner.

And you had a very good question, which was why is it that the banking institutions and the automobile companies were treated differently, that the criteria for receiving the funds was very different. The banking industry didn't really have to meet much, and the automobile industry did. If I recall right, you asked the question three times.

And I'm not sure he ever answered it.

WARREN: If he answered it, I didn't catch it.

Obviously, it bothered me. That's why I kept asking it. There is such a difference. I mean, just take a deep breath for a second on this. We said with the auto companies you have to have an entirely new business plan. You have to go through bankruptcy. You have to wipe out your shareholders. Your debt holders have to take a hit. Your labor has to take a reduction. Your management team is at risk for being fired; some of them got fired.

And we said to the banks, take the money, but we didn't ask for any of those things. We didn't ask that they wipe out their shareholders, that they make their debt holders take a hit, that they come up with a new business plan. We didn't ask for any of that. We just said here's the money.

And I really wanted to understand that. You know, this isn't a political cheap shot that I was engaged in. I want to understand. If it's taxpayer money on the line, if these are described as systemically significant institutions and that's the reason for coming in, did he think the banks were better run? We know there were problems in the auto industry, but I would think this crisis would suggest there were some problems in the banking industry.

The Treasury Department on behalf of the taxpayer was tough in dealing with the auto industry. Some still think maybe we shouldn't have gone in at all. But I want to make the point, they were tough. They were not tough with the banks, and I want to understand why.

ROMANO: On the banks, this notion of too big to fail and I did get several questions on this on Twitter. Why can't they fail? Why are they too big to fail?

WARREN: Well, the view of the Treasury Department is that if they fail, they will bring down other institutions, and, therefore, it will be really too hard for the economy overall. It's like hikers, you know, who are up on a mountainside, and they're all roped to each other, and the fear is that if one hiker falls off, you know, he'll tear ten other hikers off with him.

ROMANO: What do you think?

WARREN: I'm deeply skeptical about that point. I watch big institutions make really stupid economic decisions and pay the ultimate price, get wiped out.

So I start from a premise that the way capitalism works is that there is always a death threat at the end that if the business is not properly managed and properly run, it can be liquidated through we can call it bankruptcy.

We can call it resolution authority. We can call it a receivership under the FDIC, but the point is there are ways to get rid of them, to kill off the institutions that don't work, and that, ultimately, in my view, that's good for the system in that the healthy ones survive, and the bad ones are weeded out.

But, also, an absolutely important message to every institution going forward, if your shareholders don't monitor you, if your debt holders don't monitor you, if you don't monitor yourself, you could all end up out of a job.

ROMANO: Would the economy be better off if we broke up these financial conglomerates into smaller focused entities that could fail?

WARREN: That's a really good question because it goes right to the heart of the game. What's the ultimate solution? Once you've decided that Citibank is too big to fail, what's the right answer? Once you've decided Bank of America is too big to fail ¿ So that means you've just announced, although you haven't said the words, taxpayer dollars will always be used to back up this financial institution. Then there is a genuine cost to operating that institution, and that's the guarantee that's coming from the taxpayer, only that's not being figured into the price of their producing their goods and services. And all of the smaller institutions have to compete with that big institution, but they don't have those guarantees to back them up.

So my view is any institution that is too big to fail is one that distorts the economy and ultimately is very costly to all of us.

ROMANO: Should the financial institutions that have gotten the bulk of taxpayer TARP money, AIG, Fannie Mae, Freddie Mac, have they had their shot; should they be bolstered any more?

WARREN: You know, I've have a hard time about the shot we've already given them and the amount of money we've already given them. So it's very easy here to give the answer no, no, no, but I want to give an answer that I think is more realistic under the circumstances.

What is our plan to deal with these companies? We took them on and gave them money because we said they were too big to fail; they were systemically significant. It seems to me the appropriate next step, then, is to say so here's how we're going to make them not too big to fail, not systemically significant. Otherwise, we stay in this guarantor role, always putting the taxpayer backing up these oversized institutions, and that is not a place we should be.

ROMANO: So you're saying we've done this, we've tried this, and if this doesn't work, we need to regroup?

WARREN: Yeah. Actually, I'm saying we need to regroup before we even find out whether or not it worked, because working here means to me not being in the situation ever again where we turn to the American taxpayer and say here is a private institution that has to have your money because they fouled up, that we just can't be in that position again.

ROMANO: Are we going to look back in two, three years at this TARP expenditure and say, well, it worked?

WARREN: You know, everyone is going to have a point of view on this. Everyone is going to have a book about this.

But I think there are a couple of pieces of it that are already clear. One is there was a moment of panic, perhaps a moment of panic fueled by the Secretary of Treasury and a perceived need to have a strong response. TARP clearly accomplished that.

But the TARP money was spent in ways that really are ground breaking for America. They changed the rules of the game in fundamental ways.

When a business failed in the past and needed a bailout, we did it very rarely, but when we did, it was only after the shareholders had been wiped out, debt had taken a haircut; in other words, the losses had been borne privately to the extent that they could be borne privately.

What was so astonishing about the first expenditures under TARP was that taxpayer dollars were put into financial institutions that were still left all of their shareholders intact, that were still paying dividends, that paid their creditors a hundred cents on the dollar.

We put taxpayer money in without saying you've got to use up everyone else's money first. We put taxpayer money in without saying you got to show us how this business plan is totally changed. We put taxpayer money in without saying you've got to tell us how in the future this is not going to happen again, how you have a plan that says going forward we'll be nine little financial institutions instead of one aggregated, but something on the other side for this. And we didn't do that.

Once that's the case, I don't know how you ever put the genie back in the bottle. I don't know how you ever persuade either a large corporation or the wider marketplace that if you can just get big enough and tie yourself to enough other important people, institutions, that if something goes wrong, the taxpayer will be there behind it. That's a game changer.

That is a whole different approach than any we've ever used before in the United States.

I think three years from now when we've all had a deep breath and we kind of figured out where we've come out of the recession, we're going to look back at that one, and I think that's going to continue to be a "wow" moment.

ROMANO: Another question from one of our blogs, given the aggregate losses from trading, you know, as compared to the gains, is there any real economic justification for trading?

WARREN: That's and what an interesting question. I think the answer is yes.

You know, I'm teach contracts. So that means I'm completely bought into the notion that there are gains from trade, that buyers and sellers can both benefit.

It's just that, you know, there are also bubbles. There are also trades that are occurring that are not really about wealth creation. They're about fancy financial instruments. They can be driven by agents who make money in lots of trading, even though it's not necessarily beneficial for the principals. There could be a lot of things that can be wrong with these markets, but the fundamental notion of trading, yeah, I'm a believer still.

ROMANO: Okay. You've been a vocal proponent of a new agency to oversee consumer financial protection. There's a lot of resistance to it. What is the resistance? I can't quite understand why that would stop innovation.

WARREN: So let's start on the resistance. Who is the resistance. Large financial institutions and those who regulate them.

So why would large financial institutions be resistant to a consumer financial protection agency? And I think the principal answer is it would dry up a very, very, very profitable stream of income for them. It's a straightforward market analysis.

So right now we have a market in which if I put four credit cards in front of you, the full agreements, all those little inserts that come in the mail, if I put four of them in front of you, you'd have somewhere over a hundred pages of fine print that you'd have to read and decipher and make a comparison.

Nobody could make a comparison, so you pick it based on advertising and frequent flyer miles. If we had an agency that said, look, if you can't explain it, you can't sell it. And explaining it doesn't mean burying it back on page 16, in line 54 in incomprehensible text. It means put it in plain English in a page and a half.

It's not surprising that the credit card companies are spending an enormous amount of money to lobby against this. I'm just going to be blunt. I think they'll say anything that might work to try to get rid of this agency.

You know, if one we were betting, based on past performance, you'd bet that the banks are always going to win. They have all the lobbyists in town, not consumers and people who use credit cards. They make the campaign contributions, not the consumers and people who use these credit cards and have mortgages and so on. So that is part of it.

ROMANO: Now, one of Senator Dodd's recommendations is to consolidate for the regulatory agencies under one roof, and he's obviously getting resistance to that. Do you believe the Federal Reserve is too powerful?

WARREN: You know, for me, the way I think of this is about expertise.

Here's an interesting little side note. The Federal Reserve not only has the power to do monetary policy, they have also had the power now for many years to do everything that this consumer financial protection agency could do, and yet they don't do it. They didn't issue regulations. In fact, they affirmatively said we're not going to enforce the law; la, la, la, I can't hear you when you're breaking the law in the consumer area.

I don't think they're bad people at the Fed. I think the Fed gets up every morning and worries about monetary policy, interest rates, velocity of money.

No one gets up in the mornings and worries about consumer, are the products that are being issued actually do they make sense, can anybody read them, can anyone understand them.

ROMANO: With regard to consumers: how much blame should they share in the predicament that they are finding themselves in? No one forced them to put their whole lives on credit cards. No one forced them to buy homes that they couldn't afford.

WARREN: My take is that personal responsibility is a huge part of dealing with credit. But there has also been a problem with the products themselves. You know, we have both halves here. We have people who knew exactly what they were doing when they got into it with home mortgages, when they went crazy with credit cards, went to the mall and charged up too much stuff that they couldn't afford to pay for.

But we also have the flip side of the story. We have people who thought they were buying mortgages that were going to have monthly payments of $599 and never tumbled to the fact that that was actually only for the first three months or six months and that it was all going to explode after that, or people who took out credit cards, they carefully budgeted and said I can afford to buy a washer and dryer and pay it off at 8.9 percent interest. And the interest rate just got jerked up to 19.9 percent for no reason other than the bank would like to have higher revenues.

So my view of this is that it is the role of good regulation to make sure that the credit problem is not the one that is caused by putting out deceptive products. But once you clean that part of it up, it is also very clear that people should be held responsible. They should be held to their bargains, so long as the products they're buying are clear.

ROMANO: What more can we be doing to protect the middle class, to protect what Michael Moore refers to as the "American Dream"?

WARREN: Oh, you know, the answer is we're in trouble on so many fronts.

I will start with credit. We clean up the credit mess. This is like sewing up a hole in the bottom of someone's pocket. This is literally tens of billions of dollars that are just falling out of the pockets of middleclass families and making their way over to a handful of very large financial institutions. We can change some laws, and we can fix that one.

I have to say on health care, I do studies on families filing for bankruptcy in the aftermath of serious medical problems. Whatever else is going on in the debate is the reminder that even with people with health insurance are paying enormous sums for medical care, whether it's about copays, things that are denied and higher prices that they're paying for their health insurance. So whatever we can do to bring those costs under control for middle class families will help enormously.

Sending the kids to college, the costs are just out of control. And we are putting debt loads on children unlike those we have ever imagined.

The housing crisis. The way in which most American families build wealth is not through the stock market. It's by buying a home and paying it off. That is, for most Americans, their retirement account. They'll get that house paid off, live on Social Security. That'll be the in heritance for the children if they don't have to spend it down for medical care.

The chaos in the housing market is destroying wealth for middle-class families. To the extent we're popping a bubble, I get it. That's what it's going to have to be. But I worry now about overshooting in the other direction. You know, that just like a bubble pushes up too high, the collapse pushes down too low.

We're watching more and more families go underwater on their mortgages and not by 5 percent, going underwater by 25 and 30 percent. And this is going to intersect with unemployment. As unemployment keeps going up, more and more people are going to lose their houses. That means it depresses the value of the houses next door because it's all downward pressure on prices.

And, of course, the last one I would mention is the income front. As the pie grew throughout the 20th century, the portion that went to workers, went to the median earning family in the United States, it stayed the same percentage wise, but that meant a bigger and bigger pie was a bigger and bigger slice of pizza.

That began to shift in the '70s, and, ultimately, what happened is that the pie kept getting bigger. It's measured through productivity. It's measured through GDP. But the proportion that middleclass families got in income began to shrink.

As we talk about things, like what we produce in the United States, do we really have any manufacturing base, if not hard manufacturing, do we have other intellectual products where we think we have a comparative advantage, those kinds of issues about how workers get back in the role of participating in the growth in our economy, that's whether or not we're going to have a strong and vital middle class.

And, you know, at the end of the day, it's about these economic factors, but we have to remember we have fundamentally changed as a country.

In the 1950s and the 1960s, coming out of World War II, we said as a government, as a people, what can we do to support the middle class. You know that's what FHA was to help people get into homes, right? VA, GI loans on education, we looked at policies, like whether or not they strengthen and support the middle class.

Somewhere, that began to change in the late 1970s, early 1980s, and the middle class instead became like a resource to be pulled from, and you know, they became the turkey at the Thanksgiving dinner. Who could who could carve off a piece? Who can get this little piece? Who could make a profit from this piece and that piece or squeeze down on the wages? And the middle class has gotten shakier and shakier, hollowed out.

The consequences of that are far more than economic. The middle class is what makes us who we are. It's affects the poor. A strong and vital middle class is a middle class that can offer a helping hand to the poor. A strong and vital middle class is a middle class that has room, is creating new jobs to ¿ basically to suck the poor up out of poverty and into middleclass positions. The middle class is what gives us political stability. It's what gives us an America that's all bought into the whole process that what we do is not just about a handful of folks at the top who profit from it. We all profit from it, and that's why we work, and that's why we vote, and that's why we accept that the outcome of elections. And that's why we're safe to walk our streets, because we have a middle class for which this ultimately works, this country.

And every time we hollow that out, every time we take away a little piece of that, we run the risk that some of what we understood at America, some of what we know as America begins to die. That's what scares me.