
Paving the Road to “Too Big to Fail”: Business Interests and the Politics of Financial Deregulation in the United States

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Abstract

The debate over the political power of business has witnessed a revival after the global financial crisis of 2007–2009. We begin by arguing that business political fragmentation or unity has important consequences for policy outcomes. The structure of the U.S. government is conducive to incremental policy changes, often in response to business pressures. In turn, these changes shape the political interests and alliances of business. We illustrate this dynamic through an analysis of the political processes leading to the enactment of the Financial Modernization Act (FMA) of 1999, which repealed Depression-era regulations and allowed commercial banks to enter the securities and insurance business and vice versa. The FMA condoned the emergence of largely unregulated diversified financial institutions, which proved “too big to fail” during the crisis. Several factors contributed to the FMA: political institutions, international competition, the ideological convergence of the Republican and Democratic parties, and the political interests of financial industry actors.

Keywords

business, power, political parties, financial industry, Glass-Steagall

We have a new century coming, and we have an opportunity to dominate this century. Glass-Steagall in the midst of the Great Depression came at a time when the thinking was that the government was the answer. In this era of economic prosperity, we have decided that freedom is the answer.¹

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I think we will look back in ten years' time and say we should not have done this, but we did it because we forgot the lessons of the past, and that which is true in the 1930s is true in 2010.²

Long before President Barack Obama was sworn into office on January 20, 2009, conservative and liberal politicians were rewriting the history of the financial crisis to accommodate their ideological beliefs. Republicans argued that government officials contributed to the crisis by encouraging irresponsible lending by Freddie Mac and Fannie Mae, whereas Democrats blamed insufficient government regulation and oversight as a result of Bush administration policies. However, decisions made by both political parties during the previous twenty years contributed to the crisis. Legislative and administrative decisions that contributed to the housing boom and the lack of regulatory oversight were undertaken by Republican and Democratic Congresses and appointees alike. Part of the reason for the similarity in policy outcomes emerging out of Washington was that they responded to the political interests of the financial sector. We argue that individual businesses and business groups relied on their structural and instrumental power to encourage both lawmakers and regulators to give financial companies wide latitude in the interests of innovation, economic growth, and competitive advantage vis-à-vis other countries. Some of these policy changes were incremental, however, until business interests became united.

Using individual firms and membership organizations as our main unit of analysis, we show how the political interests of commercial banks, securities firms, and insurance companies evolved and contributed to a financial environment characterized by lax regulation that ultimately paved the way to the financial crisis of 2007–2009. The interests of business and its political alliances, in turn, reflected changes in the marketplace as well as the “feedback effects” of incremental policy changes over a span of fifteen years. We pay particular attention to the processes leading to the enactment of the Financial Modernization Act (FMA) of 1999, also known as the Gramm-Leach-Bliley Act (GBLA). FMA repealed the Glass-Steagall Act of 1933, which barred commercial banks from engaging in the securities business, and amended the Bank Holding Company Act of 1956, which prohibited commercial banks from entering the insurance business, and vice versa.³

Under FMA, diversified financial firms were allowed to operate as commercial banks (taking deposits, making personal and commercial loans, and enjoying the protection of—and access to—what is referred to as the “federal safety net,” which includes federal deposit insurance, the Fed’s discount lending facilities, and its payment system); securities firms (brokers and underwriters, hedge funds, private equity firms); and insurance companies with minimal restrictions. We recreate the process leading to FMA using records of lobbying activity, campaign donations, archival materials, and personal interviews.⁴ Examining the political behavior of business over time allows us to: (1) shed light on the extent to which incremental policy changes responded to business pressure during periods of both business unity and business fragmentation and (2) examine how incremental policy changes shaped the political interest

of businesses and altered their political alliances. We employ a process-tracing methodology, because we believe it offers advantages for analyzing complex decision-making processes and outcomes.

Contrary to the conventional wisdom, allowing U.S. financial institutions to become diversified was not the cause in and of itself of the crisis. In fact, the United States was a laggard when it came to allowing single firms to deal in securities and to offer commercial and insurance services. But what FMA did was facilitate a change in the institutional landscape of the financial industry without creating a corresponding regulatory structure to oversee it. This was the key mistake: commercial banks continued to be supervised by the Federal Reserve and the Treasury Department—via the Office of the Comptroller of the Currency or the Office of Thrift Supervision, the Federal Deposit Insurance Corporation (FDIC), and individual states; securities firms were primarily under the authority of the Securities and Exchange Commission (SEC); and insurance companies were regulated by individual states and by the Department of Labor. Thus, FMA set the stage for the crisis because after 1999 no single regulatory government body had a 360-degree view of the entire portfolio of activities undertaken by each integrated company and the associated systemic interactions and risks.⁵ Consumer groups knew this would be the case, as a representative from the Center for the Study of Responsive Law explained at the time: “the worst part about the disjointed regulatory structure of [the Financial Modernization Act] is the fact that it obscures accountability. These regulatory structures [in the bill] are not for the purpose of rationalizing the regulatory system, but to satisfy the whims of certain special interests.”⁶

While FMA was not the first or last legislative or regulatory decision that paved the way for deregulation, symbolically its enactment represented the end of an era, because it embodied the repudiation of a cautious approach to financial markets in place since the Great Depression. FMA condoned the emergence of diversified financial institutions also referred to as “universal banks” which ultimately proved “too big to fail”; it also enabled financial institutions to enter previously prohibited activities without much oversight. For example, commercial banks were allowed to derive unlimited amounts of their income from underwriting, trading, and purchasing mortgaged-backed, collateralized-debt-obligations (CDOs), which we now know as the toxic assets at the center of the financial crisis. FMA also allowed commercial banks to engage in proprietary trading (i.e., speculative dealing in securities on their own accounts), which eventually forced the government to bail out American International Group (AIG), because its credit-default swaps were used to insure the mortgage-backed holdings of the FDIC-insured commercial banks as well as of other financial institutions. Among the U.S. firms that were deemed too big to fail and received one hundred cents on the dollar on their insured mortgage-backed securities were Goldman Sachs, Merrill Lynch, Bank of America, Citigroup, and Wachovia. Thus, we argue that FMA is vital to our understanding of the financial crisis. A review of the legislative process suggests that its adoption can only be explained if we take a closer look at the political interests of financial institutions. Before we turn to the details, let us make our theoretical model explicit.

I. Explaining Political Outcomes

There are many factors that help explain the outcome of public policies in advanced democracies. Among them, political institutions, international competition, political parties, and interest-group pressures are the most important. Below we argue, however, that the regulatory environment of the late 1990s can only be understood through the political behavior of individual firms and of the membership organizations that represented them in Washington. During the time that business was fragmented, policy changes were incremental, and reflected the impact of political institutions, international competition, political parties, and narrow business interests. Throughout the process, the evolution of business interests and their political alliances reflected the changes in the market and also the feedback effects of incremental policy changes. The “big bang” of policy change in the legislative arena occurred only after the financial industry united behind the repeal of the Depression-era regulations.

Political Institutions

There are a number of ways in which political institutions can shape the outcome of policy. Students of comparative public policies have argued that government structures and rules offer an important explanation for the shape of policy in the United States.⁷ It is generally accepted that the political structure of the United States makes it easier for organized interests to obstruct the passage of legislation than to get it enacted, but also achieve their goals via “captured” regulatory agencies.⁸ Because the U.S. state is fragmented, policy change is likely to be incremental, though not immaterial. The “feedback” effects of policies on business operations facilitate new political alliances among business actors or contribute to their breakdown.⁹ In the case of the political history of the FMA, we see evidence of both—that is, a fragmented state responding incrementally to the divided interest of business groups, and business alliances on the ground shifting as a result of incremental policy changes. For example, investment banks and insurance companies, which for many years did not want competition from commercial banks, were able to prevent the repeal of Glass-Steagall because they had the support of key members of the relevant congressional committees in both the House and Senate. In 1994, Congress decided that it would give the House Banking Committee, which had jurisdiction over commercial banks, exclusive jurisdiction over securities industry issues as well. Before that year, the Energy and Commerce Committee had jurisdiction over the securities industry. Thus, competing committees were charged with overseeing commercial banks and the securities industry, which was an impediment to reforms to integrate these industries. However, the changes in the institutional rules of the game did not have a decisive impact on the passage of FMA. As was the case prior to the efforts to centralize the process, the repeal of Glass-Steagall stalled as long as the interests of commercial banks, on the one hand, and investment and insurance companies, on the other, diverged. By the same token, while Congress was resisting the pressure to deregulate, the Fed and the Supreme Court

relaxed the restrictions of commercial banks to enter the securities and insurance businesses, respectively. The impact of these changes altered the interests of individual firms, ultimately driving them to unite behind the comprehensive overhaul of the regulatory regime. Thus, we argue that while the structure of the state had an impact on the outcome of policy, it is not sufficient to explain it without an understanding of the political interests of business and the effect prior incremental policy decisions had on their resolve to unite in the long run.

International Competition

There are a number of ways in which international competitive pressures can influence policy outcomes. First, states may respond to events abroad that may hurt the competitiveness of domestic firms. Second, the interests of domestic firms may change as a result of changes in opportunities and constraints in international markets, and, in turn, result in pressures for the state to act.¹⁰ Accordingly, pressures for regulatory convergence were evident in the United States for years prior to the enactment of FMA. Initially, U.S. banks argued that they could not compete with Japanese banks, which had become among the largest in the world and were able to have securities operations in the United States. Then in 1986, British Prime Minister Margaret Thatcher's decision to revolutionize the financial services sector with the so-called London Big Bang put additional international competitive pressure on U.S. policy makers. In 1987, the Reagan administration announced that its Treasury Department had concluded that American banks should be allowed to merge with other financial institutions if they were going to be able to compete in the international arena.¹¹ In 1989, the Bush White House argued that international competition was a motivating factor for advocating a regulatory change. The concern was not that U.S. banks could not compete with British banks, but that the City of London had overtaken New York City as the financial capital of the world.¹² However, while international competition might explain the goals and justification of the new policy and the interests of individual business firms, they are not sufficient to explain the timing of FMA. After all, the United States had for years been the largest industrial economy that maintained a wall of separation between commercial banks, and investment and insurance companies; and efforts to reform the system failed repeatedly until 1999.¹³

Political Parties

In spite of the fact that parties in the United States are more decentralized than in Europe, and that party members have their own independent power base, political parties are critical to setting the agenda for legislation.¹⁴ American parties are said to cleave exclusively on a socioeconomic dimension—with Republicans championing the interests of business and the wealthy, and Democrats championing the interests of labor and the working class. By contrast, Ferguson argues that the business community has backed candidates of both major parties since the nineteenth century to ensure that

the scope of the discussion in the political arena is contained within a capitalist framework.¹⁵ There have been significant shifts, however, and while in the early 1980s congressional Democrats were adamantly opposed to deregulation of financial services, the final passage of FMA was signed into law by a Democratic president in 1999. Thus, we argue that Bill Clinton's Third Way resulted in an ideological convergence of Republican and Democratic party interests, making the latter more open to financial deregulation.

The friendliness of the Democratic Party toward business interests became more overt in the 1980s and 1990s in response to twelve years of Republican presidencies. In a 1988 *Wall Street Journal* article, Roger Altman and Lawrence Summers claimed that the Democratic Party was better for business than the Republican. They argued that with the exception of President Reagan's second term, postwar, after-tax corporate profits were on average higher during Democratic than under Republican administrations, 5.9 percent versus 4.6 percent, respectively.¹⁶ The ideological convergence over the issue of financial regulation in particular was reflected in the respective party platforms. In 1984, the Republican Party platform read: "Republicans commit themselves to breaking down artificial barriers to entry created by antiquated regulations . . . to encourage rather than hinder innovative competition in . . . financial services."¹⁷ By contrast, the Democratic Party platform maintained that "a Democratic administration will pursue cooperation backed by trade, tax and financial regulation that will serve the long-term growth of the American economy."¹⁸ The 1988 Democratic platform continued to argue that it would "reverse the trend of financial concentration and deregulation."¹⁹ By contrast, the 1992 Democratic Party platform was largely silent on the regulatory issue and stated that "we believe in free enterprise and the power of market forces."²⁰ In addition to the White House, a number of Republicans and Democrats in Congress supported financial deregulation from the beginning of the Clinton administration. However, the undisputable embodiment of this policy convergence between the parties was the Chairman of the Federal Reserve Board, Alan Greenspan. A former Chair of the Council of Economic Advisors under the Nixon administration, Greenspan was nominated as Chairman of the Fed by President Reagan in 1987. At the time, it was well known that, unlike the outgoing Fed chairman, Greenspan would be a supporter of financial deregulation.²¹ Greenspan's policies were later rewarded with a nomination to a third term by President Clinton in 1996. Thus, while FMA was not enacted until the end of Clinton's second term because commercial banks, securities firms, and insurance companies continued to be divided, the convergence of the Republican and Democratic parties on economic policies helped set the stage for the repeal of Glass-Steagall.

Organized Interests

There are many kinds of groups in Washington; the United States is, after all, *The Interest Group Society*.²² However, not all groups are created equal due to their differences in: (1) structural power; and (2) instrumental power.²³ As Charles Lindblom

explains, business groups have a privileged position vis-à-vis other groups in society by virtue of their structural power. Their ability to affect employment makes politicians sensitive to the interests of business rather than risk layoffs and the inevitable wrath of the electorate.²⁴ In addition, unlike membership organizations, business groups have the financial resources to fund their political operations. As Berry explains “fundraising is difficult and competitive” and organizations have to derive funds from sources other than membership dues.²⁵ Membership organizations that have been in operation for many years and have had to expand the representation and services they offer to maintain their membership. By contrast, business organizations do not face the same pressures and their superior resources enable them to wait longer for the outcomes they want. Businesses also enjoy multiple memberships; they are members of trade organizations and industry groups, but also of single-issue groups and may have more than one Political Action Committee (PAC) to contribute to political campaigns. Big business, in particular, has the added advantage of being able to hire their own individual lobbyists and maintain their own individual offices in Washington, D.C. This is important, because, as Wilson reminds us, “much of what is called lobbying involves . . . simply gathering information on what an immensely complex, and cross-pressured government is doing or may do in the future.”²⁶ For the purposes of this study it is worth noting that many of the major financial industry players had offices in Washington, D.C., in addition to their multiple interest-group memberships. During the process leading to the repeal of Glass-Steagall, businesses were represented by membership organizations such as the American Bankers Association, the Securities Industry Association, and Independent Insurance Bankers of America, but also by the lobbyists and representatives of individual firms. In addition, many made significant PAC contributions via their trade organizations’ PACs, individual PACs, or both. In fact, the press repeatedly reported on the campaign contributions of the financial industry.²⁷ This combination of structural and instrumental power makes business an important political actor, regardless of whether it is fragmented or united.

Lindblom’s “market as prison” argument has been understood to imply that business only turns to the exercise of instrumental power when its structural power is insufficient to achieve its goals. However, we argue that business relies on its structural and instrumental power simultaneously. Firms are competitors in the political arena as well as in the marketplace. A federal system of divided governments with executive bureaucracies, regulatory agencies, specialized committees, and congressional party leaders is an invitation for businesses to mobilize politically and to pursue their own narrow interests.²⁸ However, just because firms may be pursuing their own narrow interests and/or employing instrumental strategies does not mean that their structural power is irrelevant. Every so often, structural power is conveyed to policy makers via instrumental means, and this is especially true when business is fragmented. Accordingly, investment banks and insurance companies formulated structural arguments and conveyed them via instrumental means to block the repeal of Glass-Steagall in Congress. They found a receptive audience in Congress by arguing that Wall Street would be less profitable or that insurance jobs would be lost all around the country and in every congressional

district. The grassroots operation of the insurance companies was formidable precisely because “every town in America has an insurance agent; even bad neighborhoods have insurance agents.”²⁹

The literature on policy feedbacks stresses how new policies provide mobilization incentives for both supporters and opponents.³⁰ The feedback effects need not result from big policy initiatives. Rather, incremental policy changes can have a reverberating effect on pressure politics and studying of the political interests and strategies of business over time allows us to examine the extent to which this is the case. During the political process leading to the repeal of Glass-Steagall, incremental policy changes had the dual effect of offering encouragement to commercial banks advocating repeal, and inducing investment and insurance companies to reevaluate their interests and alliances. For example, in 1987, the Fed granted a petition from Citicorp, J. P. Morgan, and Bankers Trust to underwrite mortgaged-back securities, municipal bonds, and commercial paper. The Fed limited the income from the securities activities to 5 percent of the subsidiary’s gross income. The Securities Industry Association challenged the Fed’s decision in the courts, but it was upheld by the U.S. Supreme Court in 1988. In 1989, the Fed again increased the proportion of underwriting revenue to gross revenue to 10 percent and by the end of the year the Securities Industry Association members voted to end their objections to the repeal, deciding instead to help write the legislation to their liking. The latter knew their profits would suffer as a result of increased competition and yet their political interests responded to incremental changes to the regulatory regime. Thus, we argue that the FMA is a story about the perseverance and superior structural and instrumental resources business has to take advantage of a fragmented political system to promote its narrow or collective interests, and about the impact incremental policy changes can have on business political interests, alliances, and strategies. The latter, in turn, help explain the big policy changes, which are the focus of so much scholarship.

II. Legislative History of the Financial Modernization Act of 1999

In the sections below we recreate the political history of the Financial Modernization Act of 1999, paying particular attention to the factors that played a role in the policy process (see Table 1). We employ a chronological approach that highlights the interplay of factors during the Reagan, Bush, and Clinton administrations. First, the structure of the U.S. government explains in large part how financial institutions were able to thwart each other’s interests in Congress, even after the Republicans centralized leadership in the House; it also explains how the Fed was able to advance the interests of commercial banks in 1987, 1988, and 1996, in spite of the legislative logjam. Second, concerns with international competition were evident from the first Reagan administration and continued to be significant until the final passage of legislation. Third, ideologically, political parties were also moving in the same direction as the policy consensus. The first time a bill allowing for financial integration made it out of the

Table I. Financial Reform in the United States, 1981–2000

Year	Congress	House	Senate	President	International Competition From:	Political Structure (congressional Committee Structure)	Incremental Policy Changes	Financial Industry
1981–1982	97th	D	R	R Reagan	Japanese banks	Fragmented	—	Divided
1983–1984	98th	D	R ^a	R Reagan	Japanese banks	Fragmented	—	Divided
1985–1986	99th	D	R	R Reagan	Japanese banks	Fragmented	—	Divided
1987–1988	100th	D	D ^a	R Reagan	Japanese banks City of London ^b	Fragmented	Fed	Divided
1989–1990	101th	D	D	R Bush	Japanese banks ^c City of London	Fragmented	Fed	Divided
1991–1992	102th	D ^a	D ^a	R Bush	City of London	Fragmented	—	Divided
1993–1994	103th	D	D	D Clinton	City of London	Fragmented	—	Divided
1995–1996	104th	R	R ^a	D Clinton	City of London	Partial centralization	Fed Supreme Court	Divided
1997–1998	105th	R	R ^a	D Clinton	City of London	Partial centralization	—	United in 1998
1999–2000	106th	R ^a	R ^a	D Clinton	City of London	Partial centralization	—	United

^aDenotes that the Financial Modernization Act made it out of a congressional committee and saw some floor action.

^bThe “Big Bang” liberalization of financial services in Britain came into effect in 1986.

^cThe Japanese real-estate bubble burst in 1991.

Table 2. Evolution of Business Interests: Support (S) or Opposition (O) to the Integration of Commercial Bank, Securities, and Insurance Operations

Year	Commercial Banks	Securities Firms	Insurance Companies
1983	S	O	O
1984	S	O	O
1985	S	O	O
1986	S	O	O
1987	S	O	O
1988	S	O	O
1989	S	Conditional S ^a	O
1990	S	Conditional S	O
1991	S	Conditional S	O
1992	S	Conditional S	O
1993	S	Conditional S	O
1994	S	Conditional S	O
1995	S	Conditional S	O
1996	S	Conditional S	O
1997	O	S	S
1998	O ^b	S	S
1999	S	S	S

^aSecurities firms voted to end their opposition to the repeal of Glass-Steagall as long as they were also allowed to expand into commercial banking and have access to the Fed's emergency borrowing. After 1996, they were more forcefully lobbying for its repeal.

^bCommercial banks opposed the repeal until the merger of Citicorp and Travelers at the end of the year.

Senate Banking Committee was in 1984 under Republican Senate leadership with the support of a Republican administration; the Democratic House refused to go along. The first time a similar bill made it out of both House and Senate committees was under Democratic congressional leadership and a Republican administration. The final bill was passed by a Republican Congress and signed into law by a Democratic president in 1999.

Finally, we show how the political interests of large commercial banks, securities firms, and insurance companies evolved (see Table 2). We underscore for each financial subsector how changes in the marketplace and incremental policy changes by the Fed and Supreme Court resulted in changes in their political interests, which translated into policy outcomes when they presented a united front. The impetus for the legislation was the declining profits of commercial banks in the 1970s and 1980s. Beforehand bankers were not clamoring to be allowed to enter the securities and insurance business. Faced with declining profits, however, large commercial banks lobbied Congress and the Reagan administration for a legislative change to the regulatory regime, which was, in turn, resisted by securities firms and insurance companies that did not want

competition from large commercial banks. Year after year, the political advocacy of large commercial banks kept the issue salient despite opposition from other parts of the financial sector. In the late 1980s there was a change in the political interests of securities firms, which—as a response to the Fed’s actions—decided they would no longer object to a repeal of Glass-Steagall as long as they were allowed entry into commercial banking. Subsequent decisions by the Fed in 1989 and 1996 to further relax the rules preventing commercial banks’ entry into the securities business helped to erode any vestiges of opposition by the investment bankers and led them to actively advocate repeal.³¹ Efforts to repeal Glass-Steagall and the Bank Holding Company Act during the Bush and Clinton administrations had been thwarted by the insurance companies, which benefited from a strong grassroots lobbying operation. Insurance companies, responding in part to a 1996 decision by the Supreme Court, reversed course during Clinton’s second term and decided they now wanted to enter the commercial banking business. At this point, however, large commercial banks began to lobby against financial overhaul. They were satisfied by the advances they had made without the legislative changes, and were wary of legislation that would subject them to oversight by securities and insurance regulators. Finally, in 1998, changes in the marketplace, resulting in part from the aforementioned incremental policy changes by the Fed and Supreme Court, prompted banks to join forces with securities firms and insurance companies. For the first time all three groups were united in their support of FMA. The resulting regulatory structure supported by business resembled the proverbial Swiss cheese; while the structure of the financial industry was allowed to change, the oversight structure did not.

The Reagan Years

In the late 1970s commercial banks began to argue that the restrictions placed on them by Glass-Steagall and the Banking Act of 1956 were largely to blame for their declining profits. The Republican administration and Senate Republicans began to advocate the commercial banks’ position from the outset. By contrast, House Democrats and then-Fed Chairman Paul Volcker believed that allowing federally insured commercial banks to merge with other companies whose profitability was more volatile was too risky. In 1984, for example, there were a number of House committee bills that sought to restrict commercial banks, even to the point of forcing some of them to divest from operations that violated the restrictions embodied in Glass-Steagall and the Banking Act.³² After the midterm elections, when Democrats recaptured control of the Senate and maintained control of the House, there was a shift in the Democrats’ position, as former opponents of deregulation became open to change. The Democratic leadership of the House Banking Committee decided to push forth with a repeal of Glass-Steagall. However, divisions within the financial community, reflected in the positions of the different congressional committees with overlapping jurisdiction over the legislation, thwarted the efforts of commercial banks to achieve financial deregulation.

Evolution of Business Interests: Commercial Banks

The evolution of commercial banks' interests with regards to Glass-Steagall was the result of important changes in the financial markets. During the 1960s and early 1970s large commercial banks had very little interest in expanding into other areas of finance because they were able to make money from interest-free or low-interest deposits, safe government securities, and commercial loans. By the mid-1970s their profitability started to erode because bank customers began to look for higher-return investments such as mutual funds and money market accounts, and borrowers were able to secure loans from other sources such as commercial paper and junk bonds.³³ From the point of view of the banks, the fact that *their* customers were no longer using their services meant that securities firms were invading their territory. In the words of one bank executive, "the banks are fenced in. Others can come inside the fence, but we can't get out."³⁴ Thus, commercial banks complained to Washington that they should be permitted to enter the securities business. The industry wanted a legislative solution to the problem and their urgency was evident in the pages of the newsletter of the American Bankers Association, the *ABA Banking Journal*.³⁵ In the meantime, commercial banks took advantage of the removal of restrictions to intrastate and interstate mergers and bank operations and acquired competitors, which led to a big wave of commercial bank consolidations during the 1980s and 1990s. There was significant consolidation in Europe as well. U.S. and European banks took advantage of financial deregulation in the United Kingdom and acquired a number of investment banks.³⁶

In April 1987, Citicorp, J. P. Morgan, and Bankers Trust petitioned the Fed for permission to establish a subsidiary that could underwrite municipal bond, mortgage-backed securities, and commercial paper. In a puzzling decision, the Fed—which was still under the chairmanship of Paul Volcker—granted the banks' request as long as the securities activities did not exceed 5 percent of the subsidiary's total revenue. A few months later, a Reagan administration official declared publicly that in order for American banks to compete in the international arena they needed to become "big." The financial industry and mainstream press had been reporting that U.S. banks were no longer among the largest in the world; Japanese banks were now the world leaders and they, along with European banks, were in a buying spree in the United States.³⁷ The undersecretary of the Treasury, George Gould, explained: "If we are going to be competitive in a globalized financial-services world, we are going to have to change our views on the size of American institutions, people are going to have to accept that some big American financial institutions will need more capital to be competitive."³⁸ Later that year, during a speech before the full Board of Fed governors, the newly appointed Fed Chairman Alan Greenspan declared his support for an outright repeal of Glass-Steagall. The speech was motivated, in part, by a bill introduced by the Senate Banking Committee Chairman William Proxmire (D-WI), who had been an opponent of repeal, but had become a supporter.³⁹ The House Banking Committee was also considering similar bills at that time, but it seemed more concerned than the Senate with how banks entering the securities business would be regulated. Support for

allowing commercial banks to affiliate with other financial firms also came from the heads of other banking regulatory agencies such as the Federal Deposit Insurance Corporation (FDIC) and the Comptroller of the Currency.

Banks argued that they were at a disadvantage vis-à-vis other financial institutions, because securities firms could innovate in ways that banks couldn't, such as packaging and reselling car loans and mortgages.⁴⁰ Large commercial banks also argued that Glass-Steagall had been a solution to a nonexistent problem. As a representative from J. P. Morgan explained during the Senate Committee hearings, "there is no evidence in the legislative history that the failure of any large bank was attributable to the underwriting or dealing of activities of its securities affiliates."⁴¹ The American Bankers Association supported the Senate bill but not the House version, while the Independent Bankers of America, which represented smaller banks, opposed them all. The insurance and securities industries were wary of losing market share to the banks and their lobbying made passage of any bill highly unlikely. Securities firms also argued that a repeal of Glass-Steagall would result in banks taking more risks because they were FDIC-insured and the government would not allow them to fail; and that the securities business is too risky for insured banks, as evidenced by the stock market crash on October 1987. Insurance and securities firms were ready to stand united in opposition to the bill. As a lobbyist at the Independent Insurance Agents of America explained, "We've sat down with the securities people and agreed that everyone has to preserve their own turf . . . we've always had an alliance in the past. I don't see why it won't stand up now."⁴² Both groups had important supporters in the Banking Committees and on the Senate floor. In the Senate, where individual senators can wield more influence over legislation, Senator Chris Dodd (D-CT) would not allow any commercial bank expansion into the insurance industry and Senator Alphonse D'Amato (R-NY) was adamantly against expansions into the securities business. Senator Dodd explained that for him the issue was as important as "hogs in Iowa."⁴³ Smaller banks, which would not have had the capital to merge with other financial services firms, also opposed the bill because it would make them less attractive to consumers.

Only the Senate bill passed. The House bills were never brought to the floor for consideration, namely because the House Commerce and Banking Committee Chair, John Dingell (D-MI), would not go along with the House Banking bill. To some it seemed that it was a jurisdictional battle, and to a certain extent it was, but only because each committee responded to the interests of different constituencies. It was, by all accounts, a victory for the insurance and securities industries, which were able to influence the process to their advantage and in line with their interests. The events of the 100th Congress are illustrative of the efforts by banks to get members of Congress to do away with the wall of separation between commercial, securities, and insurance businesses—only to come up empty handed. Congress felt the pressure to act, but as long as the financial industry was divided, opponents to the regulatory change would take advantage of the structural fragmentation of the U.S. government to stop legislation.

The Bush Years

The Bush administration was very active in its support for a repeal of Glass-Steagall. Treasury Secretary Nicholas Brady, a former investment banker, argued that commercial banks needed to be able to enter the securities and insurance industries in order to ensure their competitiveness and survival. As it was the case during the Reagan administration, while the House Banking Committee was willing to push for repeal, the House Commerce Committee did not; their views reflected the diverse and generally conflicting interests of the financial sector. A fragmented political system, however, enabled the Fed to unilaterally increase commercial banks' limited entry into the securities industry. The Commerce Committee criticized the Fed's decision but was unable to reverse it; a fact that undoubtedly contributed to the securities firms' decision to end their opposition to the repeal of Glass-Steagall. Their move was conditional however, because they also wanted commercial banking privileges in exchange. The insurance industry was not as flexible and lobbied Congress to increase commercial bank restrictions. What is ironic about this period is that at the same time the Bush administration and many members of Congress were advocating for a deregulatory solution to the low profitability of the banking sector, they were dealing with the Savings & Loans crisis, brought about by deregulation. In the end, both supporters and opponents of a repeal failed in their efforts to craft legislation to their liking and the status quo was preserved.

Senator Proxmire (D-WI) retired at the end of the 100th Congress and Donald Riegle, Jr. (D-MI) replaced him as the new chairman of the Senate Banking Committee. Senator Riegle voted for the Senate bill in 1988, but he was also a supporter of the securities industry. His election as chair in 1989 coincided with the news that the Fed had raised the limit on revenue from noncommercial bank activities from 5 percent to 10 percent and allowed five commercial banks to underwrite and sell in all debt and equity securities. The Securities Industry Association blasted the Fed's move, arguing that it would "undermine the safety barriers" between commercial and investment banking.⁴⁴ Later that month Citibank announced that it would take mortgages from its own balance sheet and repackage them for sale via its Citicorp subsidiary in Delaware. The Securities Industry Association, whose members had seen a decline in profits as a result of the 1987 crash, responded by suing Citibank to prevent it from underwriting and selling mortgage-backed securities. But for the large commercial banks it was nonsensical that they would be prohibited from doing in the United States what they were allowed to do in overseas markets.⁴⁵ In March, the newly elected President George H. W. Bush and his Treasury Department announced that they would aggressively support the repeal of Glass-Steagall in order to help U.S. banks be more competitive domestically and internationally. A few months later, *The American Banker*, a financial newspaper, reported that for the first time in decades no U.S. banks were among the world's twenty largest; their report was disseminated by the mainstream press.⁴⁶ However, both the Bush administration and Congress had to spend the better

part of the year working on a bill to bail out the Savings & Loans industry, and took no action regarding the expansion of banks into the securities or insurance businesses.

Evolution of Business Interests: Securities Firms

In a remarkable turnaround, however, the Securities Industry Association announced in December 1989 that its board of directors voted to end their longstanding opposition to the repeal of Glass-Steagall. The Securities Industry Association decided that, instead of fighting the repeal of Glass-Steagall, they would try to shape legislation to their liking. In exchange, securities firms wanted to be allowed to expand into commercial banking and have access to the Fed's emergency borrowing. The Fed, the Comptroller of the Currency, and the FDIC would continue to regulate banks and the S.E.C. investment firms. Securities firms acknowledged that the repeal of Glass-Steagall would result in increased competition and reduced profits, but the decision "was a strategic effort to stop playing defense and begin focusing on limiting the access of banks into the business."⁴⁷ The Securities Industry Association had challenged the Fed's 1987 decision to allow commercial banks to establish subsidiaries that would engage in limited underwriting, but it had been upheld by the U.S. Supreme Court in June 1988. Still undeterred, the Association continued to fight repeal in Congress, when the Fed decided once again to further relax the commercial banks' restrictions in 1989. In spite of successfully blocking the repeal of Glass-Steagall in Congress, the incremental decisions by the Fed led the Securities Industry Association members to reconsider their political interests and political strategies.

By the early 1990s, concerns with competition from Japanese banks were overshadowed by fears that the City of London had replaced New York City as the financial capital of the world, and jobs in the industry had followed suit.⁴⁸ After the collapse of the Savings & Loan industry and years of bank failures, regulation of the financial industry was seen as the major obstacle to profitability. The Bush administration, which sent its proposal to reform the financial services industry to Congress, believed that securities firms and insurance companies had unfair advantages vis-à-vis commercial banks. Treasury Secretary Nicholas F. Brady argued that unless Congress deregulated and made the entire financial services industry more competitive internationally, bank bailouts would continue. Thus, in 1991, alongside discussions about how to shore up the FDIC, which was facing insolvency due to the hundreds of bank failures, the House Banking Committee passed a reform bill that mirrored the administration's comprehensive proposal. The bill could not be sent to the floor, however, until the Energy and Commerce Committee acted.⁴⁹ The latter was still chaired by John Dingell (D-MI), a known opponent of repealing Glass-Steagall; the bill he produced limited banks' entry into the securities business and banned their entry into the insurance industry. This led the treasury undersecretary to complain that it contained "special interest provisions masquerading as safety and soundness legislation."⁵⁰ In the meantime, the Senate Banking Committee proposed the repeal of Glass-Steagall, with fewer restrictions than the Energy and Commerce bill, but with similar provisions

with regards to tightening banks' access to the insurance industry.⁵¹ The Independent Insurance Agents of America, with the help of the hundreds of independent insurance agents, succeeded in getting Congress to close loopholes that allowed some banks to underwrite and sell insurance. The securities industry, which had previously announced its decision to not oppose the repeal of Glass-Steagall, was wavering because it was not clear that it would get commercial bank privileges in return. Other groups opposing the bill included the Independent Bankers of America—which represented smaller banks and opposed removing restrictions to enter the securities and insurance businesses—and the Financial Services Council, which represented a diverse group of companies and favored the elimination of all restrictions, including those prohibiting commercial corporations from owning banks.⁵² By contrast, insurance companies were satisfied with the bill because it increased the restrictions on commercial banks.

Resistance from Democrats also reflected their reluctance to allow changes in the structure of the financial services industry in light of the Savings & Loans crisis, which followed its deregulation.⁵³ At the other end of the spectrum, House Republicans and some Democrats strenuously opposed the bill because it was seen as a feeble attempt at deregulation. Though insurance companies supported the House bill, it was opposed by large banks and securities firms and in the end, failed to pass the House despite appeals by the Bush administration. The Senate bill ended up being almost the opposite of what was originally intended, leading the Bush White House to threaten a veto if sent a bill that increased the restrictions on commercial banks' entry into the securities and insurance industries.⁵⁴ The final legislation passed by Congress increased the amount of money the FDIC was allowed to borrow from the Treasury in order to help troubled banks, but it did not result in the comprehensive overhaul of the financial services industry that the Bush administration advocated. By the same token, regulatory decisions that permitted commercial banks limited entry into the securities and insurance industries were left largely intact by the legislation. The outcome was, by all accounts, a win for the status quo, and a loss for the Bush administration. In spite of the change of strategy by the securities industry, the diverse and generally conflicting interests of the financial sector continued to impede the repeal of Glass-Steagall. This situation would repeat itself with a Democratic White House and Republican Congresses.

The Clinton Years

After losing four out of the previous five presidential elections, Democrats gained control of the White House and Congress in 1992. The election of President Clinton also marked an important shift in the Democratic party's position vis-à-vis the role of government and private enterprise; but during Clinton's first two years in office the administration and Congress were largely silent on the issue of financial deregulation. The period of united government did not last long, and the mid-term elections of 1994 not only saw the return of a Republican majority in the Senate but also in the House for the first time since 1954. The new Speaker of the House, Newt Gingrich (R-GA), wasted no time reorganizing the committee structure, a promise that was included in

his “Contract with America” platform.⁵⁵ One of those changes transferred the jurisdiction over the securities industry from the Commerce Committee to the Banking Committee. However, changes in the institutional rules of the game did not suffice to ensure the legislative change and the Democratic White House and Republican Congress would fail in their efforts year after year—from 1995 to 1998—until 1999, when for the first time in fifteen years all three financial industry groups were united in their support for FMA. The interests of the latter were influenced by the Fed’s decision to once again raise the limit the revenue commercial bank subsidiaries could derive from underwriting activities from 10 to 25 percent and a Supreme Court decision that allowed them to enter the insurance business.

From the very beginning of the 104th (1995–1996) Congress, it seemed that Republicans were ready to take on financial deregulation. To facilitate the process, the House Banking Committee now had jurisdiction over both commercial banking and securities issues, while Commerce retained jurisdiction over insurance issues. Initially, the Clinton administration did not propose its own bill but expressed its support for reform. The main point of contention was whether commercial banks would be allowed to enter the securities business via subsidiary of the bank or an affiliate of the bank holding company.⁵⁶ The latter option, favored by House Banking Committee Chair James Leach (R-IA), would presumably keep FDIC-insured commercial banks insulated from the risks associated with the securities business. The Senate bill would allow commercial banks to affiliate with any business, whether financial or commercial. Commercial banks were cautious in their reaction to the various bills being considered because they feared that a major overhaul would require them to reverse their advances into the insurance business. As during the Bush administration, the insurance lobby advocated stricter restrictions on the banks and convinced the Commerce Committee to go along.⁵⁷ A lobbyist for the Independent Insurance Agents of America explained at the time: “The silence of the Leach bill [on insurance issues] allows a continuation of the status quo, and the status quo isn’t good enough.”⁵⁸ There was also the question of whether securities firms, some of which had affiliations with insurance and commercial businesses, would be allowed to enter the commercial banking business. By this time, securities firms were willing to negotiate a repeal of Glass-Steagall, but they were not convinced that they would be allowed to enter the commercial banking business in exchange.⁵⁹

Prospects for passage of the bill were no better than they had been in the past and eventually the White House, along with committee Democrats, decided not to support the House Banking Committee bill.⁶⁰ By the end of the year it was clear that there would be no House bill sent to the floor. The American Bankers Association persuaded committee leaders to desist in their efforts to bring a bill to the floor because, among other things, it would have imposed a moratorium on the ability of the Comptroller of the Currency to give banks more latitude to sell insurance. The insurance industry had been aided in its efforts by the support of influential “friends” in Congress, among them, the Speaker of the House Newt Gingrich (R-GA), the Rules Committee Chairman and former insurance agent Gerald Solomon (R-NY), and Majority Whip

Tom DeLay (R-TX), and managed to help fashion a deregulatory bill that was steadfastly opposed by larger banks.⁶¹ As DeLay explained, “we are not interested in a bill this year if it is this controversial and we have to pick between our friends.”⁶² The following year the story repeated itself; while the Senate waited, the House bill was redrafted several times, but the large banks’ opposition to restrictions on selling insurance kept it in committee. Any hint that legislators would be asked to pick sides among the banks, securities firms, and insurance companies on the floors of Congress proved highly unlikely during an election year. Even as he announced that he would give up on the passage of legislation, however, Leach continued to push for a reduction in commercial banks’ restrictions. Leach’s motivations are hard to explain. On the one hand, “he was under a lot pressure from the Republican leadership because he was a moderate . . . and the leadership was always threatening to take away his banking chairmanship,” and on the other, “he was trying to do the right thing.”⁶³ Leach, who did not accept PAC or out-of-state contributions, was clearly convinced that deregulation was the best course of policy and before Congress went on recess, he sent a letter to the Fed supporting an increase in the amount of gross income commercial banks subsidiaries could derive from their securities business.⁶⁴ In December 1996, the Fed announced that it would increase the limit from 10 to 25 percent.

Passage of a financial modernization bill also eluded the 105th (1997–1998) Congress. Initially it seemed that neither the House nor the Senate was interested in working on the legislation. In the Senate, Banking Committee Chair Alphonse D’Amato (R-NY) was not inclined to act because he was facing a tough re-election campaign. The White House took the initiative and came forth with its own plan that would allow banks to enter the securities and insurance industries without any restrictions if they used holding companies or bank subsidiaries and also would allow them to earn a portion of their revenues from commercial (i.e., nonfinancial) activities. Consumer groups and some Democratic legislators opposed permitting banks to affiliate with commercial businesses. By now, securities firms were eager for a bill that would allow them entry into commercial banking without having to divest from other commercial or insurance businesses, while large commercial banks continued to be wary of legislation that could roll back regulatory and court decisions.⁶⁵ The new version of Leach’s House Banking Committee bill would make the Fed the regulator of the holding company while the other federal banking regulators and the S.E.C. would continue to regulate the commercial and securities businesses, respectively. Against the wishes of Leach and the ranking committee Democrat, Henry Gonzales (D-TX) the committee voted to allow a financial holding company to invest in non financial businesses, thereby permitting securities firms to enter the commercial banking business without having to divest from their commercial enterprises.⁶⁶ The House Commerce Committee managed to draft a bill in late October, but commercial banks were adamantly opposed because it would give the S.E.C. and state insurance regulators too much oversight into their business, something that they had managed to avoid thus far.⁶⁷

Evolution of Business Interests: Insurance Companies

In the midst of the congressional impasse, 1997 saw a wave of consolidations, partly as a reaction to the Fed's decision at the end of 1996 to allow commercial banks to derive up to 25 percent of a subsidiary's total revenue from nontraditional activities. This third change in the limit introduced by the Fed is yet another illustration of how incremental policy change can have a reverberating effect on the marketplace and on the political interests and strategic alliances of business. Investment and brokerage firms were now merging at a faster pace and also being bought out by U.S. and European commercial banks.⁶⁸ Earlier in the year, the Morgan Stanley Group, an investment house, announced that it was merging with Dean Witter, Discover & Co, a brokerage and credit card company. The merger was largely a defensive move, as the chairman of Morgan Stanley explained, "Consolidation is inevitable . . . so it makes sense to pick your partner. This is the strongest possible combination we could make."⁶⁹

Securities firms were keenly aware that unless Congress reversed the course, large commercial banks had the advantage, leading the director of government relations for Merrill Lynch to remark, "you are a sitting duck right now . . . they can come in and buy you."⁷⁰ In April, Bankers Trust announced its acquisition of Alex. Brown & Sons, an investment and brokerage firm. Remarking on the uncharacteristic move by Alex. Brown & Sons, which had claimed that it would never merge, its chairman remarked, "everybody is a seller at some price."⁷¹ And the insurance industry was now hinting that it also wanted Congress to permit its entry into commercial banking. This was also a defensive move in reaction to the 1996 Supreme Court ruling that permitted national banks to sell insurance in towns of five thousand or fewer residents. In July 1997, State Farm Mutual Automobile and Casualty Insurance, at the time the largest property and casualty insurance company in the United States, announced that it filed an application with the Office of Thrift Supervision to form a commercial banking subsidiary.⁷² In September, the Travelers Group, which was also among the largest U.S. commercial and property insurers and also owned Smith Barney, a brokerage firm, announced its acquisition of Salomon Brothers, an investment house. By all accounts, Travelers wanted to merge with a large commercial bank but knew regulators would likely block the acquisition, so it decided to shop for an investment firm instead. When Travelers failed in its efforts to acquire Goldman Sachs, it opted for Salomon Brothers. Reflecting the trend toward the consolidation of financial services, the *New York Times* remarked, "After combining with Salomon Inc., Travelers will rival the likes of Merrill Lynch & Company, the American Express Company and Citicorp, as well as the biggest financial companies in Europe and Japan."⁷³ State Farm's decision to enter the banking industry and the Travelers Group's being public about its desire to merge with a large bank illustrate how much the interests of insurance firms had changed. Along with securities firms, insurance companies were now pressuring Congress to legislate a repeal of Glass-Steagall and the Banking Act to enable them entry into the commercial banking and securities business, while at the same time ensuring a lax regulatory oversight of their new operations.⁷⁴

When legislators returned from their winter recess in January 1998, there was a new impetus to pass legislation. The Republican leadership hyped the financial modernization bill as a bonanza for consumers, who would benefit from one-stop shopping for financial services.⁷⁵ The debate had also taken a turn; the dominant question was no longer whether banks should be allowed into the securities and insurance businesses and vice versa, but who would regulate whom. Reflecting on the lack of regulatory coherence in the House bill, a spokesman for the Center for Responsive Law explained that “the worst part about the disjointed regulatory structure of [FMA] is the fact that it obscures accountability . . . these regulatory structures [in the bill] are not for the purpose of rationalizing the regulatory system, but to satisfy the whims of certain special interests.”⁷⁶ Once again, commercial banks did not like the new legislation being considered; allowing securities firms and insurance companies into the commercial banking business meant more competition. The way the bill was drafted, it also meant more regulation because, while there would be functional regulation, the Fed would also be the universal regulator with authority to regulate the new activities of banks. Thus, the *American Banker* argued that the Fed could potentially impose “banking doctrines of safety and soundness on securities firms.”⁷⁷ The banks’ opposition and lack of support from House members persuaded the Republican leadership to pull its bill from the floor without a vote.

It was at this point in the process—a week later to be precise—that Citicorp announced that it was merging with Travelers, creating the world’s largest financial services company, one combining commercial banking, securities, and insurance services. The announced merger was a complete turnaround; John Reed, the chairman of Citicorp, was known for his dislike of the securities business. But it was the chairman of Travelers, who for a while had been toying with the idea of purchasing a bank, who first approached Citi. Once they agreed to merge, Reed expressed confidence that the Fed would approve the merger because it had signaled since the appointment of Greenspan ten years earlier that it would support the integration of financial firms.⁷⁸ The merger sent the signal that commercial banks would now be more inclined to overcome their objections to the legislation.⁷⁹ The new entity now known as Citigroup became a major proponent of the bill because otherwise, federal regulators, who continued to operate under the rules of Glass-Steagall Act of 1933 and the Bank Holding Company Act of 1956, would have no choice but to force it to break up within two to five years. When asked to explain its approval of the recent bank mergers during a House Committee hearing, the Federal Reserve Governor Lawrence Meyer explained that the Fed was obligated to consider whether mergers will result in “undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices.”⁸⁰ Barring those impediments, Meyer maintained that the Fed was obligated to approve mergers proposals independently of whether or not it “like[s] the particular combination of firms.”⁸¹ A few weeks later Greenspan went further and explained to a Senate committee that “the market will continue to force change whether or not Congress acts.”⁸² The Fed had the power to stop the Citigroup merger; there was not expectation that it would, because to do so would go against its expressed interests of allowing the integration of financial firms.⁸³

On May 13, the House Republican leadership managed to pass the FMA bill by one vote. By all accounts the proposed merger between Citicorp and Travelers and the strong support from securities and insurance firms had provided new impetus for the legislation. H.R. 10 allowed the integration of commercial banks, securities firms, and insurance companies via the creation of financial holding companies, which would be regulated exclusively by the Fed. This structure was meant to insulate affiliates from each other's failures. Thus, while there were some differences between this bill and the one that had been pulled from the floor, it retained the Fed's regulatory authority; the White House was not pleased. The Treasury Department, which houses the Office of the Comptroller of the Currency, and also has oversight over commercial banks, was opposed to giving the Fed exclusive regulatory control over the new financial entity.⁸⁴ Another point of contention in the House bill required regulators to consider the new holding companies' record of lending in disadvantaged communities mandated by the Community Reinvestment Act (CRA) of 1977. The veto threat by the White House and the opposition of Senators Phil Gramm (R-TX) and Richard Shelby (R-AL) to the CRA requirements was enough to kill the Senate's progress on the bill. Congress adjourned and shifted its concerns to the November elections.

The End of an Era

After the 1998 mid-term elections, questions about what would be the regulatory landscape after financial services firms were allowed to integrate continued to dominate the debate. The creation of the holding company structure supported by the Fed and small banks, represented by the Independent Bankers Association, was opposed by large banks because there was a chance it could open the door to oversight by securities and insurance regulators. Secretary of the Treasury Robert Rubin remained adamantly opposed to the holding company structure. He argued that commercial banks should be allowed to conduct other nonbanking financial activities via the operation of subsidiaries of the parent bank and be regulated by the Treasury and the Comptroller of the Currency. He maintained that this structure would be a more flexible arrangement and would allow banks to better compete globally.⁸⁵ The Fed's Chairman Alan Greenspan disagreed and argued that the holding company structure would be safer because it would shield subsidiaries from each other's failures. It also would prevent securities and insurance subsidiaries from benefiting from government protection intended for FDIC-insured banks. In May, the Senate bill proposed by the Banking Committee under the chairmanship of Gramm, passed by a 55 to 44 party-line vote. It increased the regulatory authority of the Fed at the expense of the Treasury's, and the White House immediately threatened a veto.⁸⁶ By contrast, the House bill, which had been reintroduced by Chairman Leach, passed in June by a 343 to 86 bipartisan vote, with 74 Democrats changing from a "no" vote in 1998 to a "yes" vote in 1999. The latter argued that the support of the Clinton administration had contributed to their change of mind.⁸⁷ In turn, the administration supported the House bill because it now allowed banks to engage in securities and insurance businesses via bank subsidiaries while maintaining the Treasury's oversight authority.

The CRA requirements also divided the House, Senate, and the Clinton White House until the very end of the deliberations, as did the issue of consumer privacy once financial services companies were allowed to integrate. However, no longer were the large commercial banks, securities firms, or insurance companies in disagreement about the spirit of the legislation and their support for the bill was what ultimately resulted in its enactment. As noted by *Congressional Quarterly Weekly Report*, during the final days of the process “the prospects for the bill appeared grim on several occasions, but industry lobbyists stepped up the heat whenever discussions appeared on the brink of collapse.”⁸⁸ The unified lobbying by the financial services community forced the Democratic administration and Republican Senate to reach a compromise, even when it seemed that their differences would be irreconcilable.⁸⁹ The regulatory environment that emerged from the deliberations was negotiated by Treasury Secretary Larry Summers—he had replaced Robert Rubin when the latter was named co-chairman of Citigroup in October 1999—and the Fed’s Chairman Alan Greenspan. Summers and Greenspan agreed that both agencies would share oversight over the new holding-company structure, but otherwise kept the regulatory regime intact. That is, the Fed and Treasury via the Comptroller of the Currency would continue to regulate commercial banks; the S.E.C. would have oversight authority over the securities operations; and the states over the insurance operations. The final bills passed the Senate along party lines and the House with bipartisan support. President Clinton signed the Financial Modernization Act into law on November 11, 1999.

In spite of the fact that the disagreement between the Treasury and Fed had delayed passage of the bill, the debate over whether commercial banks should be allowed to engage in securities-related activities via a bank subsidiary or the new financial company structure was immaterial. The crux of the bill was that the new integrated firms would be allowed to engage in largely unregulated security activities such as underwriting, proprietary trading, and/or investments in unregulated hedge funds and private equity funds. The purpose of the law was not to allow the integration of financial services while simultaneously setting up a regulatory regime that protected the economy from the escalation in systemic risk; the expectation was that the market would regulate itself. This is why commercial banks, insurance companies, and securities firms lobbied for passage of this bill. As Greenspan explained before the Annual Meeting of the American Council of Life Insurance a few days after the bill became law,

The spread of bank-like regulation over a wider ambit would bring with it not only constraints on innovation and flexibility, but also less market discipline. Creditors and stakeholders would assume that the regulators were ensuring safe and sound operations and/or that the regulators would bail out the entity if there was a problem. As a result, they would not feel the need to look out for their own interests. In my judgment, extension of bank-like regulation would increase—not decrease—risk in the financial system.⁹⁰

Not everyone was pleased with the legislation, however. A number of Democratic senators expressed their opposition and concerns about the possible risks to the economy, only to be rebuffed by supporters such as Senator Bob Kerry (D-N), who argued that “the concerns that we will have a meltdown like 1929 are dramatically overblown.”⁹¹

III. Conclusion: A New Financial Era

The repeal of Glass-Steagall and amendments to the Bank Holding Company Act that permitted the integration of commercial banking, securities, and insurance services signaled the end of an era when the fear that financial entities could become “too big to fail” kept deregulators at bay. As illustrated by Senator Gramm’s comments after the passage of the Financial Modernization Act, “freedom” from regulation and oversight characterized the new era. There are many factors that contributed to the passage of the FMA but none as important as the political interests of financial firms. Business is the most powerful group in society; its structural and instrumental powers are formidable when it is united, but also when it is divided, albeit in a different way. This was evidenced in periods during which commercial banks successfully managed to make the repeal of Glass-Steagall a salient issue, as in the 1970s, and when they prevailed over the Fed to relax the regulatory restrictions, and also by the ability of the securities and insurance companies to block a legislative repeal. In fact, for more than fifteen years, and under both Republican and Democratic Congresses and administrations, the debate was characterized more by the wrangling among different financial interests than by any other factor. The fact that the financial industry was fragmented, however, did not make its political power a nonissue. Each of the financial industry subsectors—that is, banks, securities firms, and insurance companies—made use of their structural and instrumental power to advance their narrow interests. Over time, changes in the marketplace—combined with the impact of incremental policy changes brought about by the political pressure of a fragmented financial industry—shaped the interests of business and led it to unite in favor of FMA.

International competition, government structures, and political parties also played an important role in shaping the legislation. International competitiveness was politically constructed as an important issue starting in the 1980s. At the time, most of the largest banks were Japanese and European. The Reagan administration argued that Americans should no longer be afraid of big banks if they wanted to compete in the international arena. International competition became a bigger justification for FMA after the Big Bang helped the City of London challenge New York City’s status as the financial capital of the world. Political structures were relevant in explaining the process in so far as different sectors of the financial community were in a position to obstruct legislation by virtue of their access to the congressional and/or committee leadership. There is no doubt that congressional leadership responded to the interests of their constituents. As the interests of the large commercial banks, securities, and insurance firms changed, so did the positions of many members. This was exemplified by Senator Dodd’s claim that the insurance industry was as important to him as hogs were

to Iowa. But the fragmentation of the U.S. state also provided commercial banks with other avenues to advance their interests, namely the Fed and Supreme Court. The Fed's decision to allow commercial banks limited entry into the securities business and the Supreme Court's decision to allow them limited entry into the insurance business were critical because they helped shape the interests of business and led them to unite. By the early 1990s, both parties had largely coalesced around the issue of financial deregulation. Given this scenario when large banks, securities firms, and insurance companies were united in support of FMA it did not take long for the legislation to pass (see Table 2). The evolution of their interests was a function of changes in the marketplace, such as Citicorp's decision to merge with Travelers Group, but also of incremental policy changes, such as those by the Fed and Supreme Court.

Students of American politics have sometimes found it difficult to demonstrate exactly how the superior political power of business translates into political outcomes. It is generally accepted that in a capitalist system, business enjoys a degree of structural power that other groups in society lack. However, the power of business fluctuates, and there seems to be as much evidence of business' political failures as there is of its political successes.⁹² Thus, we reach three main conclusions. First, one does not observe the influence of business on political outcomes by looking at a period when they are united and radical reform is enacted, as in 1999 with FMA. Explaining the political power of business requires a longitudinal approach that takes into account the reciprocal effects of incremental policy changes and business interests. During the 1980s and 1990s, while financial business interests were divided among banks, securities firms, and insurance companies, a number of incremental reforms took place, including the Fed's decision to relax the underwriting restrictions for commercial banks in 1986, 1987, and 1996. The impact of these changes would have remained unobservable if we only examined the political interests of business when it united immediately prior to the passage of FMA. Second, assuming that the structural power of business will only be relevant when it operates as a unified class also minimizes the impact of the structural power of individual firms and industry groups. All of the business actors in this study advanced structural power arguments via instrumental means. Finally, assuming that if business advances its interests via instrumental means it does so as an alternative to the exercise of its structural power minimizes the extent to which business relies on both its structural power and its instrumental power simultaneously.

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Notes

1. Senator Bill Graham (R-TX), cosponsor of the Financial Modernization Act of 1999, as quoted in Stephen Labaton, "Congress Passes Wide-Ranging Bill Easing Bank Laws," *New York Times*, November 5, 1999.
2. Senator Byron Dorgan (D-ND), as quoted in Ibid.
3. Even though FMA went beyond the repeal of a section of the Glass-Steagall Act of 1933 and also amended the Banking Act of 1954, the 1999 law is commonly referred to as the repeal of Glass-Steagall. Unless otherwise noted, we use FMA, Financial Modernization Act, and repeal of Glass-Steagall interchangeably.
4. With regards to our print media sources, we decided to rely primarily on coverage by *CQ Weekly Online* and the *New York Times*. The former has in-depth coverage of legislative processes and a Lexis-Nexis search revealed that the latter had the most extensive coverage of the political deliberations both in length and number of articles.
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