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Aspects of the General Economic Disaster;
More On The SEC's Culpability In Madoff
National Affairs
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I am writing this commentary on an airplane. Several points will be made, each with relative brevity - at least for me.

1. Let me start with Obama's appointments, and what some of them might portend for the economy or foreign policy.

Now, I think that all but the most partisan Republicans would hope that Obama succeeds in efforts to fix the economy and stop wars. But, to an extent I think too great, he has appointed people with a record of failure. In the economic realm he has appointed, for example, Summers and Geithner. Was this wise? True, Summers has long been considered the genius of geniuses (regardless of my dubiety about this), and Geithner too is regarded as very smart. But if my recollection is correct, Summers, in his prior incarnation under Billy Boy, was important in doing away with the Glass-Steagall Act, and put the kibosh on greater regulation of derivatives. Destroying Glass-Steagall meant commercial banks and investment banks could merge, just as they were one before the Great Depression, and then the commercial banks could be dragged down by their investment bank sides when the stock market collapsed, as happened in the Great Depression (before Glass-Steagall) and has now been repeated (after the repeal of Glass-Steagall). And as for putting the kibosh on regulation of derivatives - is it really necessary to say anything about the economic disaster this created?

As for Geithner, he was a major player in the great disaster wrought by Henry Paulson's view of what should be done. Need anything else be said?

In the foreign field, it is said that Obama is going to appoint, as the head of his National Intelligence Council, a man who is claimed to be *heavily* anti-Israel and very pro-Chinese-government-repression. If these claims are true, stay tuned for more disaster in the Middle East and in our relations in the Far East.

But, people say, Obama will control what his underlings do, instead of being controlled by what they think and what they therefore tell him. This is a nice theory. But, as a person who has headed an institution for 20 years and who also reads a lot of history, I can tell you it is only partly true. The person at the top will often be influenced heavily by what his advisers think, especially if the advisers are smart. This is only the more true where the head man or woman is at the helm of a large organization and therefore cannot know most of the everyday details which so significantly determine the strength or weaknesses of policies, and sometimes is not even much of an expert regarding the policies. And when the advisers have a history of bad judgment and serious mistakes, like Summers, then it does not matter if they have IQs of 180 or 200 or twice as high as Einstein's. Rather, they are likely to keep making the same kinds of mistakes because, perhaps sad to say, people's fundamental attitudes and beliefs usually do not change much. Rather, most people are guilty of what Einstein himself described as insanity: they keep doing the things which failed before in the expectation that the results will change. Bah!

2. Another example of the above relates to the banks like CitiBank, perhaps Bank Of America, and others, and to the auto companies as well.

Although there is now the beginning of some talk about the government possibly nationalizing the big banks, the administration has for a while seemed fixed on continuing to pour money into these entities and the auto companies, while keeping them private and under the same management, on the theory that they are too big to be allowed to fail. This "philosophy" is usually hogwash. The reason is itself philosophical, I suppose, but not untrue for that.

When institutions have gone dramatically downhill, and only the more so when they have gone dramatically downhill because of horribly mistaken and inept management - which is the story of the banks for about a decade and the auto companies since the early '70s - you are far more likely to resolve the situation successfully by getting rid of them and starting over with new institutions and new, competent management. We need new banks, and new auto companies, with new managements. Only in this way do you get people who are not devotees of, are not ridden with, the ways of thinking and the habits that caused failure in the first place. (So, you see, the point being made here is the same as the one made with regard to Summers and Geithner). The auto companies have been an off and on disaster for over 30 years, the huge, now crippled banks have been a budding disaster for ten years. If you want to succeed, get rid of them, get rid of their managements, and start over with new, competent banks and auto manufacturers under new, hopefully competent managements.

(For those who like sports, I note the obvious analogy that, the vast preponderance of the time, a football or basketball coach who is a bust one time is a bust again - and again, and again. The exceptions - Bill Belichick, Pete Carroll when he went from the pros to college - *are* exceptions.)

3. There is a theory floating about that one of the reasons for our regulatory difficulties is that, once Glass-Steagall was vaporized - significantly at the behest of Sanford Weill, who wanted to create the financial colossus that is now semi-expiring because its investment banking arm has brought it down - the various regulatory agencies lost control, as it were, because each of them had only a partial vision of the institutions it was regulating. For instance, the SEC knew from nothing about commercial banks, and the Federal Reserve knew from nothing about investment banks. According to this theory, the solution is to have a super-regulatory agency that regulates all aspects of the financial system.

Hogwash. All that a super-regulatory agency will accomplish is to insure that one day the institutions will all go down at the same time, in a reprise of today. Antitrust professors and lawyers of my generation, particularly those who write favorably about or represent huge mega companies, like to proclaim - without evidence - that bigness is not badness. Like hell it's not. When institutions of any type get too big they are going to go downhill. There are reasons, which I and others have argued elsewhere, but the reasons need not be plumbed here. Here all that matters is the regularly observable fact. And when we get one huge regulatory body, regulating huge, Sandy Weillish, created-by-greed-and-more-greed financial supermarkets, the huge agency and the financial supermarkets *will one day fail and carry down the whole economy*, just as the supermarkets have done now. A much better idea is to divide up those supermarkets into human-sized institutions, each devoted to one field instead of all fields, and then have human sized regulatory bodies which each focus on one type of financial institution. *When failures occur in smaller institutions, they do not take down the entire economy* (notwithstanding the contrary bovine defecation which claims they do because of interlinkage).

4. The *Wall Street Journal* reported on Wednesday about a hedge fund manager named James Simons (who, I believe, was the hedge fund guy who made a cool 1.7 billion dollars a few years ago, in 2005 or 2006, I think). Simons had advised Stony Brook to put money into Madoff. But in 2003, it seems, Simons began "voicing concerns about Mr. Madoff, according to people familiar with the situation." He urged Stony Brook "to pull out all of its money," and though Stony Brook did not pull out *all* of it, his urgings led it to reduce the amount it had with Madoff.

The *Journal* goes on to say "It isn't clear exactly what bothered Mr. Simons" about Madoff. But during "a routine exam" of Simons' hedge fund, the SEC got fund employees' emails that "expressed worries about Mr. Madoff. 'We at Renaissance *have totally independent evidence* that Madoff's executions are highly unusual; one employee wrote.'" (Emphasis added.)

So, Simons - the 1.7 billion dollar man, no less, one of Wall Street's most successful investors - was worried about Madoff (but as far as one knows, did not notify the SEC), the SEC got hold of emails from fund employees expressing concern, with one email saying that the fund had "totally independent evidence" that something wasn't kosher, *and the SEC did nothing*. This, if true - and I'll bet it is true because the *Journal* is damn good on factual reporting even if its editorial pages are appalling - is still more evidence that the SEC is a co-cause with Madoff himself of the horrible events that have occurred and of the devastation wreaked on so many lives.

But maybe the Simons revelation isn't even the half of it when it comes to new revelations. In a recent story *New York Magazine* claims *the SEC looked at Madoff's books* when it was investigating Bienes and Avellino - which was *1992*. "Bernie showed the SEC his books and maintained that he could return any money requested," though many customers then decided to leave their money with him, says NYM.

But though it looked at his books - probably cooked ones - if the NYM claim is correct (as I suspect it is precisely because the SEC did publicly announce in the WSJ of December 1, 1992 that there was no evidence of fraud, an announcement that makes it logical to think the SEC might have looked at the books), the SEC did nothing. Why didn't it demand to see the securities Madoff claimed to have? Why didn't it investigate whether the purchases and sales that he claimed to have taken place in the past had in fact occurred? Why didn't it especially do such things because it had started the investigation fearing a massive fraud, as was reported by the *Wall Street Journal* on December 1, 1992? Why did it just take Madoff's word for everything? One assumes all this was because Madoff had so ardently and lengthily ingratiated himself with the SEC over the years, but who knows? What we *can* say is that *the SEC looked at Madoff's books but did nothing,* and this at a time when the Bienes and Avellino accounts apparently were only about one-half of one percent of what the SEC's horrendous negligence allowed the fraud to become if Madoff's claim about its size, when he was arrested, is correct. The SEC's horrendous negligence was thus a co-cause of about 49.5 billion dollars being lost to fraud if, as said, Madoff, when arrested, was correct about the size of the fraud.

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