

Don't Blame "Inadequate" Regulation

By [Pete Eyre](#) | 26 February 2009

Editors Note: The post below was written by Sujata Srinivasan, whom I had the pleasure of meeting at an Institute for Humane Studies seminar held at Simmons College in Boston, MA during the summer of 2007. Sujata is a Connecticut-based business journalist. She can be contacted via her website: www.sujatasrinivasan.com.

Turn in any direction these days and you're bound to be bombarded by pithy rhetoric against capitalism. "See what happens when you don't have enough regulation?" is the constant refrain from pundits and politicians. And so every crisis results in Big Government enacting Big Laws to protect us Little People from Big, Bad Businesses (who make sizable campaign contributions to Big Government).

What is both frightening and fascinating is the widespread assumption that the absence of regulations caused the current economic crisis. Such is the level of panic that there is talk of nationalizing banks in the United States! Though this is unlikely to happen, the fact that it is even being discussed as an option is food for thought.



Those who tout such measures do so on the assumption that U.S. markets are not developed enough for market discipline to function as it should. And that the principles of laissez faire are inherently flawed.

In [Against The Dead Hand: The Uncertain Struggle for Global Capitalism](#), [Brink Lindsey](#) argues that "market fundamentalism" is not the root cause of volatility as proposed by financier [George Soros](#) and sociologist [Anthony Giddens](#). He continues:

At present and for the foreseeable future, the influence of market forces on world economic affairs is deeply compromised by overweening interventionism on the one hand

and underdeveloped institutions on the other.

Lindsey pointed out that the financial crisis in Latin America, East Asia, and Russia in the 1990s shared the same cause: flawed monetary policies. In other words, the affected countries' exchange rates were pegged to the U.S. dollar, but the central banks of these countries could not maintain the exchange value of their currencies, leading to a freefall in currency values.

Fast-forward to the current sub-prime crisis. Where did all that money which built-up the housing bubble, come from? Turn the spotlight on [Alan Greenspan](#), who presided over an era of excess credit. Under his watch, homeowners borrowed more than they should have, and banks extended loans they shouldn't have. Next in line – asymmetric information. The folks at the rating agencies and the folks who packaged the collateralized debt obligations seemed oblivious to the fact that they were treading on thin ice. Wrap it all up with structural weaknesses, a fall in goods and services produced, a fall in home prices, and a shrinking market and voila – you have the perfect recipe for a recession.

The rating agencies screwed up big-time, awarding triple-A ratings to junk mortgage-backed securities. So who let them operate this way? The government. Moody's and Standard & Poor are NRSROs (Nationally Recognized Statistical Rating Organizations) who decide where investors should park their funds, since financial institutions are required by law to hold "highly rated" bonds to be able to conduct certain transactions.

In a column titled [Turning Japanese – The Audacity of Reality](#), published recently, author James Quinn hit the nail on the head when he stated:

Moody's and S&P should be banned from the rating business. They proved that a AAA rating could be bought. Pension plans, governments, companies, and individuals relied on their ratings. They colluded with the investment banks and must be punished. Their monopoly needs to be ended.

Sometime back, I interviewed economist [Howard Baetjer, Jr.](#) of Towson University for a newspaper article. We spoke for nearly an hour on the causes of this economic mess and as always, he dove right in to the trouble spots. He discussed how the Community Reinvestment Act resulted in higher foreclosures since banks were pressurized to lend money to individuals with questionable credit. Those that lent more to disadvantaged borrowers received brownie points from Congress. This practice led to a slackening of lending standards across the board, including prime loans.

Additionally, Fannie Mae and Freddie Mac lapped up huge amounts of sub-prime mortgages, building up the mortgage bubble. Wrote James Quinn:

Fannie Mae, Freddie Mac, and AIG are wards of the state. The U.S. taxpayer is obligated to pay \$150 billion to AIG and \$200 billion to Fannie Mae and Freddie Mac. AIG is using these funds to undercut other insurance companies in pricing insurance policies. This will

result in insurance companies that did nothing wrong being put out of business by the government supported goliath that almost brought down the financial system. Fannie & Freddie are being pushed by Barney Frank and his distinguished colleagues in Congress to provide more 3% down loans to people who won't pay them back. The Fed then buys the loans and pretends they are good collateral, while not revealing the true value to the public. Sounds like good policy to me. These companies need to be euthanized and any decent assets sold to viable companies.

Is reverting to a command economy the solution to this crisis? It seems Quixotic to say that government regulations are the solution to a problem that clearly stemmed from government regulations. Don't you think?


For more on this, check out the [Enjoy Capitalism](#) and [Stop Rentseeking!](#) overviews and [End the Fed](#) group on Bureaucrash Social.

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Tags: [Against the Dead Hand](#), [Anthony Giddens](#), [Barney Frank](#), [Brink Lindsey](#), [capitalism](#), [Community Reinvestment Act](#), [economic crisis](#), [end the fed](#), [enjoy capitalism](#), [Fannie Mae](#), [fiat currency](#), [Freddie Mac](#), [George Soros](#), [Howard Baetjer](#), [Institute for Humane Studies](#), [nationalization](#), [regulation](#), [stop rentseeking](#), [Sujata Srinivasan](#), [the federal reserve](#)

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4 Responses to "Don't Blame "Inadequate" Regulation"

1.  [J. Nick Puglia](#) Says:
[February 27th, 2009 at 1:21 am](#)

The hard part is convincing others of what should be so clear.

2.  [joetauke](#) Says:
[February 27th, 2009 at 2:26 am](#)

It's truly terrifying how the mistake of overvaluing mortgages has translated into a rallying cry for a government takeover of enormous swaths of the American economy.

If history has taught us anything about economics, it's that basic free market principles outpace central planning every time. The government can actually help this process in certain ways - like

busting monopolies, or even, yes, regulating more transparency for complicated financial instruments that traders don't fully understand - but this doesn't mean that the government has magically become inherently better at creating GROWTH than individuals.

There's an excellent [rant about this subject here](#).

“But over the past month, the country has watched as our leaders have argued about the basic elements of free markets versus central planning. We have listened as they argued over just how much debt was enough. We have been told that the government can achieve economic goals that individuals and businesses cannot.

Many of us disagree. Vehemently.”



3. [Chris Berry](#) Says:

[February 27th, 2009 at 10:25 am](#)

Great minds must think alike. I posted a very similar article just a couple of days ago. Please check it out.

[Don't Blame Our Problems On The Myth Of Unbridled Capitalism](#)



4. [Anonymous](#) Says:

[March 1st, 2009 at 3:32 am](#)

Very relevant in light of the Govt's latest ideas on revitalizing the economy.