Written by **Charles Scaliger** on March 26, 2009

Geithner's Nationalization Plan Won't Work

It's official: the Obama administration intends to nationalize the entire financial sector. If there were any lingering doubts as to the intentions of President Barack Obama and Treasury Secretary Timothy Geithner, they were dispelled by today's announcement detailing the Treasury Department's new "ramework for regulatory reform."

"Framework" is one of those Beltway-ese buzzwords that ought to send up red flags anytime it's used. The new Treasury plan ought to be more accurately styled "Blueprint for a massive new federal power grab" because that's precisely what it is. The Geithner plan contemplates "reform" (read: "federal empowerment") in four general areas, to whit:

"addressing systemic risk," "protecting consumers and investors," "eliminating gaps in our regulatory structure," and "fostering international coordination."

"Over the past 18 months, we have faced the most severe global financial crisis in generations," Treasury Secretary Geithner told the House Financial Services Committee. "To address this will require comprehensive reform. Not modest repairs at the margin, but new rules of the game."

The entire plan, along with all the other half-baked attempts to reform or bail out "the financial system" perpetrated by this and the preceding administration, is based on an almost-universally accepted fallacy, namely, that the economy comprises a "system" that must be managed for optimal performance. But the economy, including the financial sector, is not a system like a manmade electrical grid or even a natural phenomenon like the solar system. Those systems, whether manmade or natural, operate according to laws whose operations allow any observer to predict future states. Given the pathways and resistances of electrical circuitry, or the masses and orbital velocities of celestial bodies, we can foresee the strength of currents or the future positions of planets.

But the economy is something altogether different. It is less a system than a spontaneous order. While it obeys the laws of human action, it is impossible to predict future states because the economy itself is constantly in flux. The countless billions of decisions made each moment by economic actors (people) are impossible to quantify, and their future consequences impossible to predict. The most that can be said about the spontaneous order of free-market economic activity is that it will bring about dramatic improvements in the human condition if not interfered with.

Nor is a free-market economy fragile or unstable by nature; the fragility and instability that have brought about the recent meltdown are consequences of government mismanagement, not defects in the inherently self-regulating free market.

The extent that we have an economic or financial "system" at all is a direct consequence of interfering in the workings of the market, of trying to micromanage and predict outcomes for something that is neither manageable nor predictable. The "system" is not the market itself but the web of regulations and controls that know-it-all federal regulators have foisted on banks, investment houses, insurance companies, and the rest of the financial sector. That this system has failed so spectacularly is now being touted as an excuse to impose another, more severe, system of controls that may well squelch free-market financial operations altogether.

As for the "systemic risk" that Geithner wants to reduce, the Byzantine complexity of modern finance has come about primarily as the market has tried to find innovative ways of avoiding the regulatory burden, unnatural levels of risk, and moral hazards imposed by government interference. Much-maligned "credit default swaps" and similar derivatives, for example, were created to dilute the irrational levels of risk introduced by the federal government's compelling of banks to loan to high-risk borrowers. "Hedge funds," which the Treasury now intends to bring under the malignant umbrella of federal regulation and oversight, came about as the wealthy sought means to put their money where the grasping hand of government could not confiscate nor control it. Absent the efforts of government everywhere to control financial activity, market forces would have tended toward greater transparency, as interest rates and lending found natural levels.

In this same spirit, "protecting consumers and investors" means "making more regulations to relieve consumers and investors of the responsibility of making informed choices and accepting the consequences of risk." Few Americans would buy a car or household appliance without doing a lot of research and comparison shopping. This is because, if we spend our money on things that don't work, we know that we have no one to blame but ourselves. If we have genuinely been cheated, the courts provide recourse.

But very few do much research before plunking their savings into a bank account or mutual fund. The most that consumers typically think to ask is how much interest will be paid. But because we know (or think we know) that the government will guarantee our bank accounts and keep an eagle eye on investment houses, we almost never trouble ourselves to check the books of the banks and investment houses themselves.

In reality, the free market is a much better watchdog. This is not to say that fraud will never occur absent government regulation. But a private financial analyst, Harry Markopolos, informed the SEC back in 1999 that Madoff was likely a con man, since the returns on investment he was claiming were mathematically implausible. The SEC, the benign government manager, refused to get involved, despite repeated warnings from Markopolos spanning a number of years. Do we really need more of the kind of protection that the SEC gave to the defrauded investors in Madoff's Ponzi scheme?

The Treasury Department is also telegraphing its intent to coordinate its hoped-for new regulatory powers with similar departments and agencies in other countries. "We must ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States," the Treasury's press release informs us. In other words, the same kind of socialist micromanagement of financial activity that the United States is contemplating at home is to be replicated overseas, possibly under the aegis of new global financial regulatory authorities.

The new Treasury plan is riddled with the sorts of conceits that Big Government know-it-alls love. Financial corporations deemed too large or too systemically important to be allowed to fail will be subjected to especially severe government scrutiny, complete with a new "systemic risk monitor" tasked with determining when levels of risk are too high. Left unremarked is how the government will decide how large is too large, or how much risk is “excessive.” No individual or committee could possibly make such calls, of course, but that won’t stop the insufferable Beltway know-it-alls from trying.

All of this is completely unconstitutional, of course. Nothing in the original construction of the interstate commerce clause was intended to give the federal government carte blanche to nationalize financial operations as it sees fit. But the lack of constitutional legitimacy has never troubled the Beltway know-it-alls in the past, and it doesn’t bother them now.

The new Treasury proposal amounts to illegitimate nationalization of the nation’s finances in everything but name, the culmination of a decades-long process that began in the 1930s with the creation of the SEC, the FDIC, and other first-generation financial command-and-control systems. Now that the regimentation of the once-free financial markets has failed so spectacularly, Obama, Geithner, and company are proposing to cap decades of federal mismanagement by a financial power grab unexampled in American history.