What Dodd's Bill to Clip Fed Powers Really Entails

Senator Christopher Dodd and fellow Senate Democrats are proposing to scale back the regulatory authority of the Federal Reserve and eliminate the Office of the Comptroller of the Currency, among many other provisions in a new 1,136-page bill made public on Tuesday. Dodd, the chairman of the Senate Banking Committee, blamed the Fed for alleged failures in consumer protection and regulatory oversight that contributed to last year's financial implosion.

Senator Dodd's bill would create a new Consumer Financial Protection Agency to protect consumers against so-called "predatory lending practices." It would also create a Financial Institutions Regulatory Administration that would impose tighter regulatory oversight on banks. A new Agency for Financial Stability would have the power not only to enforce new financial regulations but also to break up large financial firms whose activities are deemed a threat to the economy as a whole.

Besides the Office of the Comptroller of the Currency, the bill would also abolish the Office of Thrift Supervision and take away the regulatory authority of the Federal Reserve and the Federal Deposit Insurance Corporation. Derivatives, hedge funds, and other private pools of capital would be subject to federal oversight and regulation for the first time, and new rules would be imposed on investment rating agencies.

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Representatives of the financial sector, unsurprisingly, have voiced strong opposition to the new bill. Edward Yingling, president of the American Bankers Association, told the Associated Press that the bill "would produce conflicts among regulators, undermine the state-chartered banking system and impose extensive new regulatory burdens on those banks that had nothing to do with creating the financial crisis."

Consumer advocates, Senate Democrats, and even a few Republicans have expressed support for the measure. Democratic Senator Mark Warner of Virginia, one of the bill's major supporters, claimed that the measure would prevent future government bank bailouts. "Never again should the American taxpayers have to hear about 'too big to fail,' where the American taxpayer has to pick up the slack," Warner said.

While we heartily applaud that sentiment, Senator Dodd's new bill will accomplish nothing of the kind.

Greater and more pervasive regulatory oversight of the financial sector will — by further distorting the free market's operation — increase, not diminish, the likelihood of future financial meltdowns. With each new financial crisis, special interests and their lickspittles in government will plead yet again for the government to rescue imprudent firms deemed too big to fail.

Most of the current mess stemmed from too much, and not too little, government interference in the workings of the free market, including the perverse lending practices encouraged by the Community Reinvestment Act and government subsidizing of the mortgage industry. Curtailing the powers of the Federal Reserve is certainly a worthy goal, but transferring those powers to yet another cluster of constitutionally illegitimate federal agencies amounts to substituting one bad medicine for another.

A similar financial regulatory reform bill is being shepherded through the House by Senator Dodd's counterpart on the House Banking Committee, Congressman Barney Frank. From the muted reaction of the so-called Republican opposition, it is probably safe to assume that sentiment in favor of more financial regulation is strong in both parties.

Lost in all the hubbub of political puffery is the real crux of the matter: Why should the Federal government do anything at all? And even if there were any moral or economic basis for the government once again moving to clamp down on the free market (which there is not!), what possible constitutional basis can there be for effecting a takeover of the entire financial sector? Yet again the federal government — with the full complaisance of most Senators and Congressmen of both parties — is trying to use the power of the state to solve what only the private sector and the free markets can accomplish, and ignoring constitutional limits on their own power into the bargain.

Photo of Sen. Dodd: AP Images