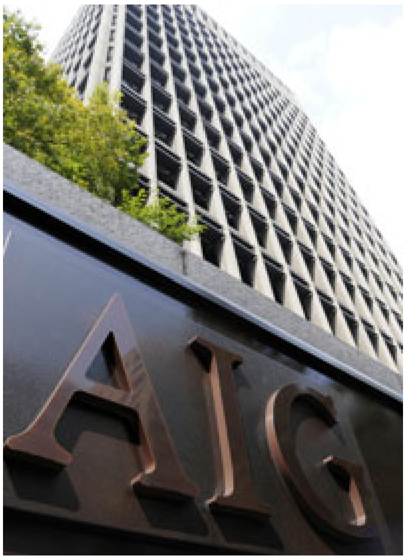
AIG, the Fed, and Accelerating Socialism



Following on the heels of the nationalization of Freddie Mac and Fannie Mae, the seizure of AIG sent markets reeling the following day, and with good cause: despite the $85 billion loan the Fed extended to AIG, the recovery of the insurance behemoth is far from certain. To service its debts, AIG will have to find buyers for large asset chunks. If it fails to do so, American taxpayers will foot the bill.

In exchange for its largesse, the Fed received an 80 percent stake in AIG and the authority to replace senior management. The unprecedented deal has put the Federal Reserve and the federal government in the insurance business without so much as a by-your-leave from Congress. "The move represents the largest lurch toward socialism that this country has ever seen, and signals the end of the vibrancy of America's once vaunted free market economy," Peter Schiff, president of Euro Pacific Capital, told the news agency Agence France-Presse. "Since there is no limit to the amount of money the Fed can create, there is no limit to the number of assets they can acquire."

In point of fact, the hard laws of economics will impose limits on the Fed's powers — eventually. This bailout, like a whole series of Federal Reserve actions since last December, was carried out in concert with the Department of Treasury. The Fed usually creates money by purchasing government debt, meaning that the Treasury must issue new debt against which the Fed can then create new money in the form of loans like the $85 billion extended to AIG. In this instance, the U.S. Treasury has agreed to play its part, and will be selling $40 billion in 35-day bonds to help fund the takeover.

It need hardly be noted that the federal government, much less the executive branch, has zero constitutional authority to nationalize corporations (the entire Federal Reserve operates completely outside the bounds of constitutional legitimacy, since the Constitution only authorizes the federal govenrment to "coin money," not to print it). Such dictatorial interference in the free market, however, was routinely embarked upon by the FDR Administration, in spite of resistance from the Supreme Court, Congress, and the American people. Roosevelt's New Deal, with its make-work programs, bank holidays, seizure of private assets, and welter of new controls on industrial and financial activity, marked the genesis of Old World-style fascism — where public-private partnerships and state-sponsored monopolies are substituted for the free market — in America. In the decades since, the public has come to perceive such activities as a necessary evil, its unconstitutionality notwithstanding.

The direct seizure of AIG by the Federal Reserve marks a dangerous new move towards autocracy. Federal bailouts are hardly new, but until recently, were generally not undertaken without congressional approval. Consider, for example, the federal government's celebrated bailout of Chrysler Corporation in the early 1980s. In December of 1979, Congress, under intense pressure from President Carter and irate constituents, passed the Chrysler Corporation Loan Guarantee Act (which only guaranteed a loan if needed). The U.S. Military then brought thousands of Chrysler pickup trucks, helping the storied firm to avoid bankruptcy. Nowadays, apparently, the say-so of a president, Treasury secretary, or Federal Reserve chairman is regarded as sufficient authority to commit billions of dollars of federal funds to feckless bailouts — this despite the fact that the U.S. Constitution requires that all spending bills originate in the House of Representatives, thereby committing the government's purse strings to Congress, not the Executive Branch.

The seizure of AIG is being justified, as usual, as an extraordinary action to protect a corporation deemed too large to fail. But what really happens when corporations fail, as storied investment firm Lehman Brothers did just a day before AIG's "rescue"? Those assets with value are purchased by other firms and recincorporated into the economy. Debt and excess value is liquidated, often causing short-term market upheavals but ultimately leading to necessary corrections and a return to more rational valuation. Government bailouts and other artificial lifelines merely postpone the evil day, prolonging economic turmoil and victimizing taxpayers into the bargain.

Wall Street is starting to catch on, as Wednesday's precipitous stock market decline showed. It is starting to dawn on investors at home and abroad that not only does the U.S. government not have the money to bail out the entire financial sector, it would only exacerbate the problems already in evidence. Each new bailout creates a "moral hazard," encouraging investors, bankers, and financiers to behave recklessly in the belief that, should they ever face severe financial consequences for risky behavior, the government will spare them in turn from having to face the consequences. Taken far enough, such misplaced government largesse will create a system so burdened by excessive risk and misallocated assets that it will collapse like the proverbial house of cards.

Make no mistake about it: American taxpayers will ultimately pay a heavy price for the bailouts of AIG, Fannie Mae, and Freddie Mac, as well as any other foundering corporations the feds choose to "rescue" in coming months. Always the rationale is the same: investors and the economy must be protected. But in point of fact, the chief beneficiaries are always those who stand to lose the most — the giant investment firms, hedge fund managers, wealthy bankers, and others whose immense wealth depends on the survival of the system — in a word, those who benefit from the Federal Reserve's inflationary policies, and who have the assets and the clout to enlist the government to protect their fortunes.

Ordinary Americans, by contrast, not only get stuck with the taxpayer's tab, they also see their assets lose value as a consequence of inflation. Every time the Fed extends a loan, more money is pumped into circulation, leading in the long run to higher prices. The bailout of AIG has been accomplished by pumping $85 billion new dollars into the economy overnight — this on top of tens of billions more the Fed has already released this week via its open-market operations.

Beyond the inevitable economic and financial fallout of such ruinous policies, the activities of the federal government, and the Federal Reserve in particular, in responding to the latest wrinkles in the great credit crunch, are wreaking havoc with our entire political system. The Federal Reserve has, since last December, usurped enormous new powers over the economy, and is poised to assume still more if Treasury Secretary Paulson’s plan for a new financial regulatory regime is put into effect. The plan, made public last spring, envisioned a revamped Federal Reserve with vast regulatory and surveillance authority over every facet of American financial activity. It would in effect create a financial counterpart to the Department of Homeland Security, with the Federal Reserve as its lynchpin. With the seizure of AIG, the Federal Reserve has begun assuming the very powers envisioned by Paulson and the Bush Administration, without even a congressional debate.

As the economy continues to unravel, look for the Federal Reserve to continue to remold itself into an autocratic new Ministry of Finance. With the impending implosion of Washington Mutual, the world’s largest thrift, as well as other regional banks, the possible failure of a money-center bank or two (Citibank, for instance), and the potential collapse of one or more of the Big Three automotive giants, the Federal Government will have adequate pretext to continue the truly revolutionary onslaught on America’s "once-vaunted free market economy."

(AP Images)