Bernanke Urges More Regulation of Financial Sector

Fed Chairman Ben Bernanke is growing impatient. With the financial crisis continuing to drag on, Bernanke appeared again before Congress yesterday to urge lawmakers to pass legislation aimed at preventing future economic crises of the severity of the ongoing Great Recessioan.

Among Bernanke's proposals: a new mechanism, analogous to the FDIC for ordinary commercial banks, to safely close down and liquidate the assets of failing mega-financial firms whose unsupervised failure could put the entire system at risk. The costs of such a system should be borne by the financial industry and not by taxpayers, Bernanke emphasized.

Congress also needs to put in place better mechanisms for regulators to monitor risks within the financial system, so that major risks in the future may be spotted and dealt with before reaching proportions that would endanger the economy as a whole. Bernanke was mum on what organization or organizations should be given such powers of oversight, but in previous testimony, he has recommended that the Federal Reserve be transformed into regulator of last resort for every part of the financial sector.

The Fed also acted unilaterally this week to crack down on the supposedly excess compensation of bank executives, promising on Thursday to subject banks and their salary and bonus packages to withering scrutiny in what the *New York Times* called "one of the most far-reaching responses yet to last year's financial crisis." Bernanke has already telegraphed his intention to transform the Fed into an all-purpose financial regulator, with or without congressional complaisance. Thursday's announcement, in conjunction with Bernanke's congressional testimony yesterday, is a clear sign that the Fed means business.

Congress has so far dragged its feet, despite having such comprehensive reforms urged on it by the likes of Bernanke and Treasury Secretary Tim Geithner. Yet now is the window of opportunity for such reforms, Bernanke pointed out yesterday. With the crisis on the wane and economic activity picking up, the political window of opportunity to overhaul the system should not be squandered.

For a man who allegedly supports free-market capitalism, Bernanke is remarkably enthusiastic about government control and regulation of the financial sector. Most of the distortions responsible for the magnitude of the ongoing crisis can be traced directly or indirectly to prior government interference in the workings of the free market, yet Bernanke, undismayed by the inability of government to "manage" the economy better than the private sector, is recommending — as he has for months — more, not less, government supervision as the cure.

But more government controls, complete with a parachute for failing mega-corporations, will inevitably encourage moral hazard. Large financial corporations, secure in the knowledge that their assets will be protected in the event of a complete meltdown, will not scruple to take more risks than they would otherwise have done — much as commercial banks, protected by the FDIC's umbrella, were willing to do with risky subprime mortgages in the lead-up to this crisis.

More government regulation and scrutiny will encourage the creation of more and more complex investment strategies designed to dilute risk and accountability in a climate of stifling authoritarian federal oversight — just as banks and other financial companies did in the repackaging and parceling out of risky mortgages that federal regulations like the Community Reinvestment Act forced them to undertake.

As for the notion that the costs of a safety net for the financial sector will be absorbed by financial corporations and not by taxpayers, everything done by government is paid for by taxpayers. In this case, the costs may not be assessed directly by higher taxes, but they will inevitably be foisted on the private sector over the long haul in the form of inflation and higher costs for carrying out financial transactions (those attractive $10.00 per trade online commissions may well become a thing of the past, for example, as financial corporations are forced to raise their fee structures to pay for new government assessments).

It is impossible to anticipate the shape that future government-encouraged financial crises may take, but that's precisely the point. As would-be central planners found out long ago, successful economic planning is impossible. What Bernanke is proposing is a looser, Americanized version of the same kind of economic planning that hamstrung socialist and communist economies of the past, except that instead of the straitjacket of total nationalization of finance, he is recommending the shackles of open-ended regulation and supervision. Under such a regime of controls, the captive economy may still be able to move and grow, but its freedom will be severely curtailed and its potential stifled.

Photo of Ben Bernanke: AP Images