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Free Enterprise: More tools for paper tigers

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The cat is finally out of the sack - and it is a kitten.

This week's blueprint for a Financial Regulatory Reform, announced by the administration with great fanfare, has as the byline "A New Foundation." That ambitious statement is, fortunately, overhyped.

Rather than rebuilding the regulatory framework, the 88-page document (available at <http://tinyurl.com/ntsodl> [1]) aims for adjustments at the margins.

That should be of comfort to those who feared that the administration would get carried away in its drive to assert powers that previously - and rightfully so - were allocated squarely into the realm of private markets. One example of such restraint is the design of innovative financial instruments, which this plan will still permit.

On the other hand, those who had asked for additional safeguards, especially with respect to transparency, can take heart in plans to regulate "all over-the-counter derivatives" and to create a "new regime to resolve nonbank financial institutions whose failure could have serious systemic effects."

In his speech announcing the proposed changes (available at <http://tinyurl.com/mdemnc> [2]), President Barack Obama explicitly stated that he has "always been a strong believer in the power of the free market."

Nothing in this blueprint contradicts this.

The promotion of robust supervision of financial firms (p. 19), the comprehensive regulation of financial markets (p. 43) and the protection from financial abuse (p. 55) are all laid out in terms that will still permit for the ingenuity of the free enterprise system to work its wealth-creating magic.

Shutting down, or at least limiting, the ability of the regulated institutions to shop around for their favorite regulator among the alphabet soup of agencies is undoubtedly desirable.

Spelling out more clearly which particular part in the alphabet soup is not only responsible but also accountable for what specific task is long overdue. One surprising facet is, however, the timidity with respect to rating agencies.

All the text could muster was "strengthening credit rating agency performance." That seems far too hesitant with respect to one of the main culprits of the financial meltdown.

Of course, this blueprint is just a suggestion for Congress, and the all-important details will be hammered out in the coming weeks and months.

George Soros, in his best-seller "The New Paradigm for Financial Markets," had offered "some policy recommendations" of his own. Key phrases therein included "regulators' failure to exercise proper control," "practices that they do not fully understand" and the need for market participants to provide "information even if it is costly and cumbersome" (all p. 143).

Many of the official suggestions now put forward seem to be in the same mold, namely full of trust in the ability of regulators to know what is right and when to do it.

However, when it comes to overseeing financial firms that (far too) often will also be likely future employers of current regulators, an individual cost-benefit analysis by federal employees may frequently tilt the scales in favor of the financial firm.

The reform that will conquer this basic human trait has yet to be written, and the current blueprint is not it. On the contrary, it promulgates regulators as unerringly selfless public servants.

Alas, that confidence is misplaced. The regulatory (paper)-tigers have too often been purring kittens. None of the many laudable, while only broadly defined, concepts in this plan has the capacity to change that.

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