

A New Deal for the 21st Century: Less Entitlement, More Accountability

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In a January 2011 article in *The Nation* magazine, author William Greider bemoans the death of New Deal liberalism. “When the party of activist government, faced with an epic crisis, will not use government’s extensive powers to reverse the economic disorders and heal deepening social deterioration,” Greider writes, “then it must be the end of the line for the governing ideology inherited from Roosevelt, Truman and Johnson.”ⁱ

Greider is not the only observer to note the end of the New Deal and the related unwillingness of liberals to fight efforts by members of both parties to roll-back the size of government. “[T]he public is being sold a big lie — that our problems owe to unions and the size of government and not to fraud and deregulation and vast concentration of wealth,” former Secretary of Labor Robert Reich told the *New York Times*. “Obama’s failure is that he won’t challenge this Republican narrative, and give people a story that helps them connect the dots and understand where we’re going.”ⁱⁱ

President Herbert Hoover said of the New Deal that it was an attempt to crossbreed Socialism, Fascism and Free Enterprise, part of a collectivist revolution led by FDR and carried within the Trojan horse of economic emergency.ⁱⁱⁱ The New Deal was also a way for the Democrats to finally end decades of largely unbroken Republican rule in Washington. FDR had, after all, nominated Al Smith three times as Democratic presidential nominee. The former New York governor had lost each election. FDR and the New Deal not only enabled the growth of government, but also of the private and public unions that came to underpin the finances of the Democratic Party after WWII.

Today the debate among and between liberals as to how the government should respond to the latest financial crisis is function not so much about ideology but of shrinking revenue and burgeoning obligations. The New Deal Model of defined benefits has been replaced with defined contributions or, more recently in the auto industry, profit sharing. Whereas after WWII the U.S. seemingly had the resources and borrowing capacity to address any national want or need via government fiat, today constraints on resources seems to be the dominant theme. This fundamental lack of growth and revenue, particularly in the private sector economy, is leading to a dearth of job opportunities -- a

reality that seems to have replaced the open horizons and endless opportunities that are part of the mythology of the American dream. But this is a circumstance that has been building for decades. At least since the early 1970s, when the Nixon Administration made the decision to leave the gold standard and embrace a series of socialist policy expedients, stagflation, that is, rising prices and receding job growth and economic activity, have been the predominant trends, relieved by tax cuts and spurts of monetary exuberance by the Fed.

Where we are going as a nation looks an awful lot like America a century and more ago, the era of rampant political corruption and financial excess known as the Gilded Age after Mark Twain's wonderful novel. The Gilded Age was an era following the Civil War that saw rapid growth and relatively low inflation, even compared with the post-WWII period. But it was also a period when large railroads and banks basically ran the country unchecked. Today large banks are in explicit control of Congress and the White House, and the individual American seems helpless to push back. And Democrats and Republicans alike today look to big business for financial sponsorship. The Robber Barons of the 21st Century are the managers of large banks and of the various government sponsored-agencies, and their corrupt political enablers in Washington.

Liberal advocates such as Greider, Reich and others focus on the bad acts committed by ostensibly private banks and investors during the most recent Fed-induced mortgage boom. Today's liberals have a hard time dealing with the takeover of our public institutions by large corporations, which are themselves largely unaccountable to their shareholders. Many people fail to identify the corrupt relationship between the federal government and large banks, for example, as driving social issues such as domestic jobs losses, foreclosures and growing disparity between rich and poor. "Increasing inequality in the United States has long been attributed to unstoppable market forces," Robert Lieberman writes in *Foreign Affairs* reviewing the new book, Winner Take All Politics. "In fact, as Jacob Hacker and Paul Pierson show, it is the direct result of congressional policies that have consciously -- and sometimes inadvertently -- skewed the playing field toward the rich." iv

The political narrative in America over the past fifty years has been a function of the Cold War, left vs. right, liberal vs. conservative, but is this really an accurate description of the political situation in America today? The focus by some commentators on the rich echoes the debates of a century ago, when Americans felt that opportunities were being decreased by the wealth and power of the great captains of industry and finance, the likes of Carnegie, Morgan and Rockefeller. In the new book, Exploring Happiness: From Aristotle to Brain Science by Sissela Bok, the author notes:

“Opinion surveys show that Americans are twice as likely (60 percent) as Europeans (29 percent) to believe that the poor can get rich if they only try hard enough. While most Europeans feel that where you end up is largely a matter of luck or other circumstances beyond your control, fewer than half of Americans agree. Armed with these beliefs, lower-income Americans are less likely to blame society when inequality grows and more inclined to believe that persons of great wealth must deserve their good fortune.”^v

Today, however, political as well as economic power is exercised by managers such as JPMorganChase CEO Jamie Dimon, whose former colleague Bill Daley is now White House chief of staff. Daley, the seventh and youngest child of the late Chicago Mayor Richard J. Daley, is not only the representative of JPMorgan in the White House, but is the replacement for Rahm Emanuel as chief fund raiser for Obama in the 2012 general election.

“These banks again have unfettered access to the very top of the political decision making in the United States,” says MIT professor Simon Johnson, “and reflects the fact their status is completely undiminished, despite all the mistakes they made and all the damage they did to the rest of the economy.”^{vi} Johnson argues that unless the largest banks are broken up, another major financial crisis is inevitable, a view that shared by a number of other Americans in and out of government.

Because the largest banks and their bond holders were not forced to restructure, their political power is unaffected and is growing even greater than before the crisis and with it the ability to extract public subsidies from Washington. My firm estimates that the settlement of claims by Fannie Mae and Freddie Mac against Bank of America by Treasury Secretary Tim Geithner, for example, amounts to a public subsidy of tens of billions of dollars for this one large bank.

The evolution of America into a socialist state in the image of the authoritarian nations of Europe cannot be ignored, even if some superficial differences remain. The new rich of 21st Century America includes both the corporate manager and the public sector worker, the latter of whom earn twice the incomes and benefits of their peers in the private sector. Labor unions have taxed public and private sector workers to support the Democratic political machine. The New Deal political apparatus was built on a vastly increased federal government emanating from Washington, a tendency increased and expanded further by the fact of two World Wars, the ensuing Cold War and Great Society. But the America of 2011 is a victim of its own success in peace and in war, with a public sector that is too large for the real economy and that is also protected by entrenched corporate interests endlessly enriched by government subsidies.

One of the more peculiar debates in recent months has been the brewing argument over whether or not the Depression era government agencies such as Fannie Mae and the Federal Housing Administration encouraged Wall Street's subsequent bad acts in the market for subprime mortgage securities. Peter Wallison at American Enterprise Institute and Joe Nocera of the *New York Times* engaged in a argument as to whether Wall Street or Uncle Sam are most to blame for the financial crisis that began with subprime mortgages, especially the creation and purchase of private-label mortgage securities. Liberals such as Nocera defend the government agencies, while Wallison represents the conservative view that Fannie and Freddie were at the heart of the crisis and should be abolished. But both sides of this supposed debate need to recognize some profound truths that they should share and which should cause them to cooperate for change.

First and foremost, the secondary market for home loans in the U.S. has been dominated by the federal government since the 1930s. It is unlikely that a secondary market would even exist without at least a federal guarantee on these securities. The FHA, Fannie Mae and her younger sibling, Freddie Mac, have turned private banks into under-capitalized loan production offices for Uncle Sam. The government sponsored housing agencies or “GSEs” monopolize the secondary market for prime home loans, leaving only the subprime loan market available for the private banks to operate without government competition. The rates charged by the government for guarantees on mortgage backed securities are also artificially low, further blocking private competition.

A noxious combination of federal loan pricing guideless, accounting rules and bank capital regulations such as Basel II/III made it impossible for smaller community banks to retain loans and loan servicing on their balance sheets. This is one reason why banks such as Countrywide, Lehman Brothers and Washington Mutual chose thrift charters in order to avoid limits on mortgage servicing. But now that these relatively competitive players are gone, what we see today is an illegal oligopoly in the secondary market for home mortgages. The largest banks act in an unholy cartel with the housing GSEs, while community banks, smaller businesses and consumers are subordinated in the economic food chain.

Despite claims from the Obama Administration that the Treasury is making money on the bailouts for Wall Street, the taxpayer will end up footing the bill for hundreds of billions of dollars in losses from the federal housing agencies, losses caused by bad loans sold to the GSEs by the largest banks. We should recall that the avowed purpose of mortgage securitization was to vitiate the effects of the business cycle and ensure that the housing industrial complex would always be funded. This policy, however, interfered with the normal market process on Wall Street of weeding out crackpot ideas and poor performers.

Liberals like my friend Nocera defend the GSEs because they believe that government should help people. The ideal of “affordable housing” subsidized by Washington has

become part of a larger agenda for members of the left, something to be defended and preserved. But when you look at the predatory nature of the GSEs and their incestuous relationship with the largest banks and investors, it is hard to make a case that these New Deal agencies are actually helping the poor buy their own homes -- their piece of the American Dream.

Just look, for example, at the way that Fannie Mae and Freddie Mac rules encouraged banks to price loans to borrowers in less attractive areas. The result was more expensive loans to borrowers but also mortgage bonds that were less likely to prepay. These subprime loans were sought after by investors and the GSEs themselves, who stockpiled these high "spread at origination" or SATO loans in their portfolios. Who are we helping here? These same GSEs charge below-cost guarantee fees to the largest banks, which then pay outlandish bonuses to themselves based on their sales of securitized loans to investors. If we had a President and Treasury Secretary who truly represented the interests of the American people, the taxpayer would be capturing this economic rent instead of the largest banks.

To be fair to Nocera and other GSE-loving liberals, the private sector has plenty to be ashamed of in the mortgage banking business. Subprime lenders preyed upon minority customers in Georgia, North Carolina, and other states, people who already had substantial equity in their homes. These unscrupulous lenders systematically stripped these borrowers of their wealth. But, again, Washington was an accomplice in the rape. As states sought to protect their citizens, state officials ran into determined opposition from the banking industry. Its captive regulator, the Office of the Comptroller of the Currency, then under former and now again bank lobbyist John C. Dugan, claimed the power to preempt state consumer laws.^{vii}

Just as many conservative observers believe that the introduction of the New Deal by FDR actually weakened the economy during the Depression, today the growth of government is arguably undermining the checks and balances of our federalist system and making our economy progressively weaker. The introduction of the Federal Reserve

System in 1913 gradually undermined our private banks, clearinghouses and financial markets, making all of these important economic sectors dependent upon public support and the protection of regulation. Concepts such as “Too Big to Fail” start with the New Deal mandate that government regulation would replace market forces as the arbiters of the financial markets. It is not merely that the banks have captured the politicians, but more, they exist in splendid symbiosis immune from public accountability.

Modern day regulation is an offshoot of the progressive movement of the 19th Century and supposes that government can be used to stamp out evil and prevent bad acts in markets. But larceny is a necessary part of a free society. In that sense, the recent experience of the real estate markets in the US and Ireland have a great deal in common. Ian Jack asked in his review of the new book Ship of Fools: How Stupidity and Corruption Sank the Celtic Tiger by Fintan O’Toole:

“Why were people so stubborn in their refusal to see the blindingly obvious? Why had government, regulators, and speculators migrated *en masse* to, in O’Toole’s phrase, “the Republic of Catatonia”? The narrow political answer finds a British echo in Gordon Brown’s devotion to “light touch regulation” in the City of London. A democratic country that has chosen low taxes and tolerant financial supervision as the basis of its prosperity still needs to raise the funds that will deliver public goods and services. High salaries and corporate profits in London’s financial industries provided a steady tax stream to the Labour government, which allowed generous public spending.”^{viii}

It is interesting to note how little commentary there is in the US about the political link between the large banks on Wall Street and key members of Congress. The federal monopoly in the secondary market for home mortgages has created not only big profits from the banks that underwrite the debt of the GSEs, but also vast moral hazard and private sector corruption that observers such as Nocera ought to condemn equally with the bad acts of banks. The decision by the Massachusetts Supreme Court in [U.S. Bank National Association vs. Antonio Ibanez](#) makes clear the need for a national standard for

originating, selling and servicing mortgage loans. A number of financial market professionals and academics recently published an [Open Letter](#) exhorting federal regulators to include rules for loan servicing in regulations required by the Dodd Frank law.

But more than just new standards for bank behavior, we need to recognize that today the large banks and housing GSEs are actually blocking the economic recovery. If you look at how the current pricing for banks selling loans to Fannie and Freddie is affecting loan originations, it is hard to conclude that these agencies are actually helping low income Americans or anyone else but themselves. Today there are as many as 30 million American households which are effectively being denied the right to refinance their mortgages because of the predatory, anti-competitive behavior of the large banks and GSEs -- behavior that is encouraged and reinforced by regulators, the Treasury and the White House. Whereas during most recessions in the post-WWII period refinancing enabled households to re-liquefy, the current downturn has seen virtually no benefit for consumers in terms of lower mortgage finance payments. While big banks are subsidized by the Fed and the housing GSEs, millions of American consumers are being denied their contractual right to refinance their loans. ^{ix}

Part of the reason that the banks can't or won't provide re-financing for home owners today is that rates are already extremely low, but the larger issue is the continuing readjustment in home prices nationally. After two decades of government policies to support an increase in home ownership, the process is now being reversed. My friend and colleague Josh Rosner, a principal of research firm Graham Fisher, told the story at a meeting of Professional Risk Managers International Association in New York on September 20, 2007:

"The reasons for the boom in housing in the past decade were the result of structural changes in the housing industry over a decade before. Most of these changes were a result of the 1980s recession. We came out of the 1980s recession and a lot of the industry players had lost their shirts in the S&L crisis. We saw

Fannie Mae insolvent on a mark-to-market basis in 1986 and that was largely because of the portfolio of foreclosed real estate. We saw housing in 1993 and 1994 with home ownership rates stagnant, exactly where they were at the beginning of the 1980s. Home ownership rates have consistently ranged in this country between 62 and 64 percent during the post-WWII period, and yet affordability had actually locked people out."

Rosner and others have documented how Congress and the Clinton Administration laid the foundation for the subprime bust in the 1990s via affordable housing policies sponsored by Washington, including changes to appraisal and loan approval standards, and loser guidelines for loans purchased by the GSEs. As the US economy recovers from the government-sponsored boom in housing, Americans face a choice: embrace more government involvement in the economy or begin to unwind the statist New Deal structures which have brought our country to the brink of national insolvency. In particular, the government role in the housing sector needs to be dramatically scaled back if we are to ever get control over our financial markets, both financially and politically. The notion of GSEs and government intervention in the markets come from fascist wellsprings in Europe of a century ago, alien constructs that should be rejected by all Americans -- especially after the experience of the past several years.

The second half of volume three of President Hoover's memoir, The Great Depression, contains a scathing critique of his successor -- and also an admission of personal responsibility for the catastrophe. It features several times the word "fascism" to describe many Roosevelt-era prescriptions for fighting the Depression, a blunt reminder that much of what FDR did during these dark years was borrowed from the strong men of Europe — Mussolini in Italy, Hitler in Germany, and Stalin in Russia. Indeed, as my friend Joe Costello reminded me, the New Deal really takes its example from the 1880s social welfare legislation of Otto von Bismark's Germany.

Is there any doubt in the minds of all Americans, liberal or conservative, that the threat today is not from one "ism" or another, but instead the corruption and incompetence of

the managers of the expanding corporate state? Through our involvement in two world wars and the subsequent decades of American economic hegemony, our republic has become the very image of Europe, with political and economic power concentrated among a group of very large financial institutions whose fortunes are tied to that of a bankrupt federal government.

When my friends ask whether the Dodd-Frank legislation ended the practice of “Too Big to Fail,” the answer is of course not. Dodd-Frank was about creating a special ghetto for the largest banks, now explicitly protected by the Fed and Treasury from creditors pushing these firms into involuntary bankruptcy. Even were the holders of private-label mortgage securities suing Bank of America for tens of billions of dollars to win in court, for example, what then? Thanks to Dodd-Frank, the largest banks all now may hide from their creditors behind the Fed, OCC, Treasury and FDIC.

Housing, social services, public pensions and many other areas of America’s safety net are going to be pruned back in coming years because of a lack of revenue -- tax revenue - - which in turn is a function of the growth in the private sector. The fundamental truth is that without a vibrant and growing private sector in this country, many of the supposed objectives of the New Deal become impossible to fund. Keynesian economics, it seems, only has potential so long as you can borrow more money. The US has the added advantage of being able to buy our own debt -- at least for now. Once the debt spigot is turned off, however, we all become Republicans again. Just ask the citizens of the United Kingdom, who are presently going through the worst recession since WWII.

As economic growth in the U.S. has lagged that of the other industrial nations, the Congress and the Fed have resorted to fantastic borrowing and monetary expansion to correct for a basic lack of job creation and business activity. The most recent explosion in public debt to finance federal spending and supposed “stimulus” efforts comes in the context of the accumulation of trillions of dollars in obligations for everything from Medicare to loan guarantees to Social Security. All of these obligations are dependent upon a level of growth in the private sector that probably cannot be achieved, at least in the near term. Indeed, even if the U.S. economy were growing as fast as the others, it is

doubtful that we could honor all of the promises that have been made by federal and state governments since the Great Depression.

The basic truth that we all need to accept is that much of the nominal economic growth in the US during the period since WWI was a result of war and the rebuilding process that followed. The accumulation of capital in the US following WWI was an important precursor to the powerful growth in the American economy that followed WWII. But in the decades since the defeat of fascism in Europe, the ability of government to manufacture economic outcomes in the same way that America won two world wars has waned. We supplemented real economic activity with growing public and private debt. Each marginal increase in taxes, government sponsored agencies and federal debt has brought less and less benefit in terms of employment and economic turnover. And because of the dollar's role as the world's reserve currency and means of exchange, another legacy of WWII, the US currency has gradually lost competitiveness vs. other nations. Even as our creditors complain of fiscal excesses in Washington, they pursue policies to keep the dollar strong to protect financial investments and maintain export markets.

Consider the "cash for clunkers" program used by the Obama Administration to boost auto sales in 2010. While the tax credit of up to \$4,500 per old car junked did boost current sales, it did so at the expense of future sales and the cost of the debt needed to fund the program. The same can be said of the \$7,500 tax credit program to support the housing industry. The only way that government can spend money on stimulus for the auto or housing sectors is by taking money from someone else -- either via taxes or borrowing. "They (the government) either had to tax it from somewhere or borrow it from somewhere," says Brian Wesbury of First Trust Advisers. "[B]y moving resources out of one sector into another you have now messed up the natural order of things and you've influenced it in a negative way." ^x

If one examines all of the expedients deployed by President Barack Obama since he came into office, virtually all of them depend upon some action by government -- the

nationalization and bankruptcy of Chrysler and GM, and the rescue of AIG, GMAC and Citigroup. Obama shows no inclination to reduce America's dependency on federal spending and subsidies, or restructure the largest corporations. The sad truth is that as the government's role in the US economy has grown, the ability of the private sector to generate the jobs, politicians are picking winners and losers, and revenue needed to keep our nation stable and strong has ebbed. Until we have a new class of politicians in Washington who understand this basic fact, and reduce the size of government, we will not make progress as a nation.

So what is to be done? The path ahead requires that we ask Americans to take greater responsibility for their lives, families and businesses. In return, we need to restructure our federal and state governments to provide those services that are the province of the state in an efficient and transparent way, and thereby make room for private sector expansion. Governor Mitch Daniels of Indiana has done a great deal of good work in this regard and provides an example to the rest of the country, but you already see governors in a number of other states who get the message. Of note, former WV governor Joe Manchin, now a member of the Senate Budget Committee, is urging that chapter nine of the Bankruptcy Code be examined for ways to provide greater flexibility for states to restructure their debts.

In New York, fiscal issues, reform of taxes and a pairing back of the welfare state created for public sector workers over a century and more will be a difficult process -- but one that will be driven by financial necessity and the inexorable progression of demographics. These necessary changes to public sector institutions cannot be successful unless we first make changes to our private economy. We must ensure that we have stabilized important sources of private sector tax revenue that support our communities, especially areas such as property and sales taxes. In particular, the continuing decline in home prices in the US during 2011 will provide perhaps the most difficult test yet for millions of Americans who have now endured almost five years of housing price deflation, unemployment and despair -- even as inflation drives up living costs. Last year saw a record number of

home foreclosures and 2011 is likely to set a new record, a fact that will make predictions of economic recovery difficult to fulfill.

Here are three broad areas that need to be included in a new framework for guiding the American political economy of the future:

Spending & Taxes

It has been suggested to me by a former colleague at the Fed that the more problematic American states such as Illinois, California and New York will face IMF-style conditionality on spending and limits on social mandates in the future as a *quid pro quo* for federal assistance. The good news is that we are going to be forced to change many bad old ways when it comes to public spending, but the process will be daunting. The Treasury just sent the states a bill for unpaid unemployment insurance, including \$1.3 billion in interest, a bill many states cannot pay.^{xi}

Just as Ireland, Spain and the other debtor nations of Western Europe face austerity and restructuring for debt holders, we will probably see defaults by some of the sovereign states and perhaps even the federal government as part of the democratic political process of forcing fiscal change. As we shift the model of the safety net from defined benefits to need-based services, major changes will need to occur in how we care for all of our people.

At the end of this difficult course, Americans should emerge with a political consensus that results in an explicit balanced budget amendment to the Constitution, including a line item veto for the President subject to override as today by both Houses of Congress. A key part of the discussion ahead for state and local government involves spending priorities, but we also we need to focus tax policy on consumption rather than income and investment. Our tax system today taxes the corporate income of equity holders twice and makes it progressively more and more expensive for employers to hire new workers.

We need to entirely scrap the tax on corporate income and limit taxes on capital gains and personal income, especially when it is related to long-term investments that create jobs in America. In its place we need to adopt a national sales tax that compliments the state tax system and is reset each year depending upon how Congress achieves its budget goals. The national tax rate on sales should become the new measure of whether Congress does its job. To further support federal revenues, all imports into the US should be taxed at the applicable national sales tax rate at the point of entry.

More than a return to the gold standard or abolishing the Federal Reserve System, we need to place hard limits on the ability of Congress to spend money, either in the form of cash, promises of benefits or financial guarantees, so that the nation's debt can be stabilized and slowly reduced as the economy grows. And an important component of fiscal reform, ironically enough, involves real reform of the financial system.

Banking & the Fed

In a recent report to Congress, Treasury Secretary Geithner notes that it is not possible to identify systemically important financial institutions, as required by the Dodd-Frank law. Geithner's frank assessment recalls Justice Stewart, who famously said with regard to pornography that you'll only know it when you see it. Likewise the comment of Justice Learned Hand about being unable to select platonic guardians also comes to mind. This refreshingly frank admission by Geithner begs the question regarding the efficacy of the new Dodd-Frank reform legislation and regulation generally.

We need to put aside vague concepts such as "systemic risk" and instead take steps to reduce the federal safety net and open the banking sector to full competition so that bailouts are not necessary. The way to limit public bailouts in the future is first to accept that banks are not special and do not need special treatment under the law. A key first step is to repeal the Bank Holding Company Act and allow any domestic corporation to own a bank. Any public, prudential regulation of the banking industry would focus entirely on the "bank," which would be restricted as to its activities and risk taking. All

of the activities prohibited under the Volcker Rule within Dodd-Frank, as well as all agency activities in the securities or currency markets, would be conducted through non-bank affiliates as under Glass-Steagall, leaving the depository a narrowly focused provider of commodity financial services.

Along with a realignment of the ownership and risk incentives in the banking sector, Congress needs to move forward with the restructuring of Fannie Mae and Freddie Mac. At the end of this month, Secretary Geithner is scheduled to provide a road map for reform of these agencies, but no bold recommendations for reform are likely to be forthcoming.

These agencies should be merged into a single corporate entity, then run-off and liquidated. In place of the GSEs should be a series of private mortgage conduits operated by the banking industry and guaranteed by the Treasury at market rates. These entities would be subject to national guidelines on loan origination, sales and servicing as we proposed in the Open Letter already referenced. In this regard, Congress should consider requiring banks to retain the servicing of all of the loans they originate, even if the bank chooses to sell the note to a third party. More than three quarters of all loans securitized in the US today are serviced by third parties with no knowledge of the borrower or proximity to the collateral. Having the local banker retain responsibility for servicing the loan would largely eliminating foreclosure documentation mess we see today and also enhance the rights of investors and the several states when it comes to real property.

In addition to reform of our banking and housing finance institutions, we need to look at ways to separate the Treasury from the Fed, an extremely important political problem that gets far too little attention in the media. For the past half century, the Fed has essentially been acting as the *de facto* central bank for the world. More recently, the Fed has replaced Congress as a fiscal agency, again on a *de facto* basis and with no legal authorization, making loans to and investments in companies such as AIG that were never contemplated by Congress. ^{xiii}

The Fed's role as a convenient bailout mechanism for Congress and the appropriations process mandated in the Constitution makes its role as arbiter of "Too Big to Fail" with respect to banks seem trivial by comparison. For the past four years, the Fed has monetized the debt issuance for the Treasury as well as funding bailouts for deserving banksters. Consistent with calls by Rep Ron Paul (I-TX) to eliminate the Fed, we should eliminate the Board of Governors in Washington and devolve the central bank's balance sheet and payments systems back to private industry.

Bankers have always controlled the Fed, but the greater evil is allowing Congress to use the central bank as a slush fund to enable fiscal depravity by elected officials and their clients on Wall Street. In place of the Washington bureaucracy we today call the Federal Open Market Committee, we would have a decentralized and private system of at least 12 federal reserve banks with expanded, public boards subject to oversight by Congress. The Treasury would determine the required increase in currency in circulation on an annual basis. The federal reserve banks, the Depository Trust & Clearing Corp, the major exchanges and the banking industry would comprise a newly invigorated, privately managed credit and payments system beyond the immediate reach of Congress.

Confirming the ownership of the payment system by private banks would go a long way to curing the ills caused by the creation of the Board of Governors in 1927 and the New Deal more generally. By making all of the participants in the financial markets joint and severally liable for one another via membership in the Fed and the national clearing system, America would begin to restore private market discipline to Wall Street. Think of the poetic justice of reversing FDR's seizure of the private gold stocks of the banking industry in the 1930s.

In the future, the only two agencies in Washington that could respond to a financial crisis would be the Treasury as fiscal agent of Congress and the FDIC as the government's insurer of deposits and liquidator of failed banks. If you think that such a configuration would lead to economic catastrophe, then I would love to hear how one would make such a distinction given our current state of affairs.

The Dollar

Finally we need to examine and discuss with our allies and trading partners the role of the dollar as the world's means of exchange. All of the issues discussed above, particularly the loss of job opportunities in the US, the focus on housing as a means of spurring incremental economic growth, and the American addiction to debt and deficits, are influenced by the artificial strength of the dollar. This stability stems from the fact that most of the world's trade and financial transactions still flow through the dollar as does a large portion of all financial transactions. The dollar's role as the world's commercial currency allows the Fed to monetize government debt and gives consumers access to cheap imports, but inflicts a cost on American workers and companies in the form of an over-valued dollar.

Just imagine where the dollar would be vis-à-vis the euro, Russian ruble or Japanese yen if the inflation, debt and unfunded liabilities of the US public sector were fully reflected in the marketplace. Today the dollar is the world's currency and the Fed is the world's central bank. The fact of the demand for dollars as a global means of exchange essentially subsidizes the ability of the Treasury to issue debt. Just as we must separate the balance sheet of the Fed from the federal government in order to restore discipline and competitive sanity to our financial markets, so too we need to negotiate an end to the use of the dollar as the world's currency to force Congress to live within its means. Think of it as sending Charlie Sheen to the Betty Ford Clinic to live permanently.

If you take the example of the separation of the Fed's balance sheet and payments apparatus from the federal government and the enhancement of the private clearinghouse function proposed earlier, the same approach needs to be taken with respect to the dollar and the other major currencies. The US should lead a negotiation with the G-20 nations to gradually and deliberately replace the dollar as the primary means of exchange of trade between nations. A variety of means could be used to achieve this objective, including tax and monetary policy, but the initial goal should be to rebalance the policy of the post-

WWII period of subsidizing the exports of our trading partners with accumulations of public and private sector debt in the US. In the current global system, the only way to rebalance the competitive equation for US workers and exporters, and also support objectives such as lowering dependence on foreign oil, is to reduce the world's dependence upon the dollar as the global currency.

In simple terms, this final proposal means that the value of the dollar probably needs to fall relative to the currencies of some of the over 100 nations that run a trade surplus with the US. Once the dollar is more competitive vs. other major currencies and a greater portion of the world's commerce moves outside of the dollar system, America and our trading partners in this hemisphere will be the most competitive nations in the world. If we balance the needs of our own people with our obligations abroad, we can better fulfill the hopes of Americans for a brighter future and be true to the ideals of our nation's founders at the same time.

“If the US does not get its finances in order “we will have a European situation on our hands, and possibly worse”, warns Rep. Paul Ryan (R-WI), the new Republican chairman of the House of Representatives budget committee. We all should be cheered by the fact that a growing number of our fellow citizens in Congress seem to be focusing greater attention on fiscal issues than has been the case under the Democrat-controlled Congress. Think of the proposals discussed above with respect to the dollar, financial regulation and fiscal discipline as a means of ending America's special role in the world, a duty we took on at the end of WWII and carried through half a century of Cold War. Americans spilled blood all over the globe and have incurred trillions of dollars in debt to help the world recover economically. It is time for the American people to declare that the emergency declared by FDR in the depths of the Depression is over and that it is time for a return to normalcy. Thank you.

ⁱ Greider, William, [“The End of New Deal Liberalism,”](#) *The Nation*, January 24, 2011

ⁱⁱ Powell, Michael, [“Obama the Centrist Irks a Liberal Lion,”](#) *The New York Times*, January 7, 2011

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- ⁱⁱⁱ Hoover, Herbert, *The Great Depression* (1952) NY: Macmillan, Pg 357-359
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- ^v See Nagel, Thomas, “Who is Happy and When,” *The New York Review of Books*, December 23, 2010,
- ^{vi} [“Bill Daley’s Appointment Proves ‘The Bankers Have Won Completely.’ Simon Johnson Says.”](#) *Yahoo Tech Ticker*, January 13, 2011
- ^{vii} On John Dugan’s role in protecting the largest banks and helping to create the culture of “Too Big to Fail,” see Carter, Zach, [“A Master of Disaster.”](#) *The Nation*, December 16, 2009
- ^{viii} Jack, Ian, [“Ireland: The Rise & the Crash.”](#) *The New York Review of Books*, November 11, 2010
- ^{ix} For a discussion of the GSE loan pricing issue, see Whalen, Christopher, [“Bernanke conundrum is Obama’s problem.”](#) *Reuters.com*, September 9, 2010
- ^x [“Krugman is Wrong! Stimulus Spending Is ‘Hurting the Economy,’ Says Brian Wesbury.”](#) *Yahoo TechTicker*, August 10, 2010
- ^{xi} Michael Cooper and Mary Williams Walsh, “U.S. Bills States \$1.3 Billion in Interest Amid Tight Budgets,” *The New York Times*, January 14, 2011
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