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Deregulation is not always best

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Once again we have a letter from someone who is convinced that government regulations are what caused the Great Recession.

To make things right we have to give people more freedom in the marketplace. Mr. Stubblefield cites John A. Allison's book as a source for the real truth. Mr. Allison is a member of the Cato Institute – a libertarian think tank – and a big fan of Ayn Rand.

So, it is no surprise that Mr. Allison would lay the blame for the economic crisis of 2008 and its aftermath on the government.

I, too, have read several books about this economic calamity and all of them have given substantial evidence that the deregulation of the financial sector is the primary cause of that horrific mess. And the basis for the push to deregulate is the world view that is espoused by Mr. Allison, Mr. Stubblefield and far too many others.

The essence of their world view is that people, be they consumers or producers, are protected from bad deals by their own self-interest. So, people should have the freedom to buy what they want and companies should have the freedom to sell what they want.

When the government intrudes into this natural relationship with regulations, it simply mucks things up.

When this world view was applied to the financial sector, industry lobbyists put constant pressure on Congress to allow the financial institutions to modernize. So, the regulations that had protected the financial sector from major catastrophes for 50 years, should be eliminated.

In 1982 the Garn-St. Germain Depository Institutions Act was enacted which allowed banks to offer a wide variety of mortgages, e.g., ones with adjustable rates, interest-only payments or even negative amortization. Also in the 1980s financial institutions developed derivatives. Credit Default Swap derivatives are bets that some company will or will not default on its loan.

In 1994, Congress passed the Secondary Mortgage Market Enhancement Act which allowed investment banks to securitize mortgage loans, i.e., package them into bond like products called MBS's (mortgage backed securities). They then sold them to hedge funds, pension funds, etc.

Finally, in 1999 Congress overturned the Glass-Stegall Act and approved the Gramm-Leach-Bliley Act, which allowed investment banks, commercial banks and insurance companies to combine into a single firm.

Each of these acts enabled more freedom in the market by allowing consumers a wider choice of products and investment banks to create new markets for risk. There was nothing to fear because Alan Greenspan – another devoted advocate of Ayn Rand – proclaimed that the sophisticated players in these markets could police themselves. Of course we all know they didn't and what dismal consequences followed thereafter.

The folks who adhere to the simplistic world view outlined above never learn from history. They are so devoted to their theory, that no amount of evidence will ever convince them that it is incorrect. Unfortunately, too many of those with the power to steer us on a more correct course are also beguiled by these ideas.