THE DAILY SIGNAL

The Myth That Regulation Can Stop Financial Crises

Mollie McNeill

May 3, 2016

Regulation doesn't prevent financial crises—a fact that the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act conveniently ignored.

Born from the myth that deregulated markets caused the 2008 crisis, Dodd-Frank inserts the federal government into virtually all components of the financial sector. The legislation polices everything from derivatives markets to payday lending, and it has (so far) burdened the U.S. economy with thousands of pages of rules.

Unsurprisingly, these overbearing regulations stifle economic growth. Meanwhile, the causes of the last crisis have not been addressed and the number of too big to fail firms has increased. After witnessing sluggish economic recovery and alarming trends towards overregulation, experts have come together to present the case against Dodd-Frank.

This new report—a collaborative effort between scholars at The Heritage Foundation, the American Enterprise Institute, the Cato Institute, and the Mercatus Center—uses free market principals to identify the problems with Dodd-Frank and offer alternative solutions. Dodd-Frank largely ignored the underlying causes of the 2008 crisis and implemented policies that exacerbate those causes. Here are three major reforms needed in the wake of the Dodd-Frank Act becoming law:

1. **Shut down Fannie and Freddie**. These government-sponsored enterprises distort the market by relying on (formerly) implicit taxpayer guarantees. To make the housing market more stable, the government should leave these services to the private sector and revoke Fannie and Freddie's charters.

2. **End Federal Reserve bailouts**. Monetary scholars have long recognized that the too big to fail doctrine has roots in the Federal Reserve's so-called emergency lending. While a main purpose of Dodd–Frank was to protect taxpayers by restricting the Fed's ability to provide emergency loans, the bill failed to accomplish this goal. Even after these changes, many of the emergency loans extended during the 2008 crisis would still be allowed. Given the historical precedent of previous financial crises, nothing short of an outright prohibition of emergency Fed lending should be expected to mitigate those bailouts.

3. **Eliminate the Consumer Financial Protection Bureau**: The Consumer Financial Protection Bureau was established under Title X of the Dodd-Frank Act to regulate consumer financial products and services. The bureau wields unparalleled rule-making, supervisory, and enforcement powers, and operates without accountability to Congress or the executive branch.

The bureau operates as if regulatory intervention is necessary to protect consumers from themselves by limiting the availability of credit, and curtailing Americans' choices for investment and wealth creation. The bureau operates on radically different principles than those that have governed consumer protection law for decades. The best option going forward is outright elimination of the bureau through repeal of Title X of the Dodd–Frank Act.

Dodd-Frank is stifling the economy and personal financial choice, yet as of 2015, roughly 40 percent of the rules required by this legislation have yet to be finalized. Congress must decide whether to keep compounding problems brought on by Dodd-Frank, or to enact practical and effective solutions for better U.S. financial markets. This book offers practical alternatives to the misguided solutions found throughout Dodd-Frank.