NEW YORK POST

A FAKE FINANCIAL FIX

By MARK A. CALABRIA

June 18, 2009 --

THE Obama administration yesterday presented a misguided, ill-informed remake of our financial regulatory system that will make crises more likely and more costly. Our financial system, particularly our mortgage system, *is* broken -- but the Obama plan ignores the real flaws to focus on more convenient targets.

Instead of putting an end to bank bailouts, the plan makes bailouts a permanent feature of our regulatory landscape. In fact, it extends the possibility of taxpayer-funded bailouts to any company choosing to become a financial-holding company. This will likely include every large insurer, as well as major consumer-finance companies like GMAC.

Of course, the administration tells us that bailouts won't be needed -- because the same regulators who *missed* the signs of the current crisis will get added powers to prevent the next one.

We're supposed to believe that, if only the Federal Reserve had the same oversight powers over AIG as it now has over Citibank and Bank of America, that the bailout of AIG would have been avoided. Just think: If only AIG had been managed and regulated as well as Citibank -- because Citi is in such *great* shape now.

In the wake of this crisis, it's understandable that the Obama plan increases regulation and oversight of the largest financial institutions -- but why do it in ways that reduce the market discipline on those same companies?

By assembling a list of institutions deemed "too big to fail," the president is announcing that any of these select corporations will be bailed out if it fails. As a result, these institutions will face lower funding costs than smaller lenders -- which will allow them to gain market share.

That is, the Obama plan guarantees increased concentration of our financial markets: We'll have fewer banks, but larger ones -- insulated from market pressures.

In short, the Obama plan puts the entire safety of financial system on hoping that regulators at the Fed get everything right.

Meanwhile, the plan barely mentions two institutions at the very heart of the mortgage-market meltdown -- Fannie Mae and Freddie Mac. Instead, the administration tells us that it will study the issue and come back with alternatives at a later date.

Yet Fannie and Freddie were the single largest source of funding for the subprime market during its height, buying more than 40 percent of all subprime securities at the market peak, while also leading the market in the reduction of credit quality. In all likelihood, their ultimate cost to the taxpayer will be greater than that of the bank bailouts known as TARP.

Combined taxpayer losses from Fannie and Freddie could well exceed $300 billion -- twice the expected cost of bailing out AIG. Any reform plan that leaves out Fannie and Freddie can't be taken seriously.

Even when it gets things right, the plan gets it wrong: It recognizes the failure of the credit-rating agencies, but misses the source of that failure -- namely, the fact that those agencies are a government-created monopoly. So it insists on more disclosure -- which won't solve the problem. What's needed is an end to the exclusive government privileges that have been granted to the rating agencies -- and an end to the practice of having government regulators outsource their jobs to these companies.

Then there's the mortgage section of the plan. Naturally, the Obama team doesn't address the largest single problem -- the federal government's obsession with extending homeownership to households that can't sustain it. Instead, it calls for increased "consumer protections" in the mortgage industry.

Sadly, the administration can't confront the basic fact that the most important mortgage indicator is the borrower's equity: How much of its own money a household puts into the home tells us *far* more about probable default than whether the loan was adjustable-rate or has a prepayment penalty.

Admitting these facts, of course, would mean admitting that programs like the Federal Housing Administration have been at the forefront of pushing unsustainable mortgage lending.

In short, the Obama team has once again put politics ahead of policy, offering "answers" that will sound good to the uninformed without threatening any of the vested Washington interests that played so large a role in creating the current crisis.

Mark Calabria is director of fin ancial-regulation studies at the Cato Institute (cato.org).

Home