United States House of Representatives

Committee on Financial Services

Hearing on the Annual Report of the Financial Stability Oversight Council

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Congressman Ron Paul

Statement for the Record

Mr. Chairman, I welcome this hearing to receive the report of the Financial Stability Oversight Council (FSOC). The creation of FSOC underscores perfectly the complete intellectual bankruptcy underpinning the government's behavior towards financial markets. In the opinion of government leaders, the financial crisis was not caused by misguided regulation, interest rate manipulation, or government-caused distortions to the structure of production, but by a financial sector that was completely deregulated and laissez-faire. The response of legislators, therefore, was to create a new super-regulator with vast new powers to control the financial system.

Those who truly believe that the financial sector is deregulated might want to test their hypothesis by starting their own bank without the government's imprimatur, assuming that they are prepared to spend some time in a federal penitentiary. To say that the financial sector is deregulated could not be further from the truth. No other sector of the economy is as intertwined with the government as the financial industry.

Financial firms, especially smaller firms, suffer from costly and burdensome regulations that create barriers to entry in the market place and diminish competition. Excessive regulation ensures that only government-approved financial firms have a chance to enter the market. Those firms which are able to get through the hurdles are still at a competitive disadvantage vis-a-vis established firms who are better able to navigate the regulatory maze.

But not all of the government involvement is negative to the financial industry. Financial firms, especially larger ones, benefit from government bailouts, the first use of the Federal Reserve's newly created high-powered money, and membership in a government-sanctioned and -supported banking monopoly. Larger, well-established firms are not only better-suited to comply with the requirements of regulators; they are also more likely to receive bailouts from the government due to the entrenched policy of saving firms that are “too big to fail.” The moral hazard of these bailouts is obvious, yet the government continues to subsidize large, poorly-run financial firms, to the detriment of investors, the financial system, and the economy as a whole.

The very existence of financial regulators creates an enormous moral hazard, as regulations give the appearance of safety and order and entice individuals into investing in ventures that are far riskier than they appear on the surface. This skews the decision-making process of investors, causes money to be invested in unproductive endeavors, and impoverishes ordinary Americans. The existence of financial regulators has cast the old maxim of *caveat emptor* by the wayside, and the American people and the U.S. economy suffer for it.

Despite all of this, too many in Congress still believe that more government regulation will benefit the financial system, pull the United States out of its current economic malaise, and prevent another financial crisis. This was the thinking behind the Dodd-Frank Act and the creation of FSOC and the Consumer Financial Protection Bureau (CFPB). If the regulators failed to see the crisis coming and failed to act to stem the crisis, the Washington solution is to pass even more stringent laws, increase regulators' budgets, and create new agencies, commissions, and councils. The view in Washington is that if a regulator fails, make it bigger; if a law fails to prevent a crisis or scandal, create another one; and never, ever rethink your belief that more government is always the solution.

In the financial sector we witnessed the collapse of Enron and the subsequent passage of Sarbanes-Oxley, a ham-fisted attempt to reform accounting practices which had the effect of further burdening firms, especially smaller financial firms, while doing nothing to prevent the scandals at Lehman Brothers, MF Global, and other entities.

Despite the demonstrated failure of Sarbanes-Oxley to prevent the next wave of financial scandals and the financial crisis, Congress insisted on creating FSOC in the wake of the financial crisis. FSOC is essentially the President's Working Group on Financial Markets (a.k.a. Plunge Protection Team) on steroids. This organization has vast powers to interfere in all areas of the financial system under the guise of “financial stability”, yet it is far more likely that FSOC's actions will instead lead to increased instability of the financial system. An organization that can dictate orders with impunity can only create havoc.

Congressional oversight of FSOC, as with oversight of most other government agencies, is practically nonexistent. A single hearing each year, with each Congressman receiving five minutes of questioning time, is mere window dressing. Nothing substantive can be gleaned from such limited hearings. And as we all know, getting a straight answer from a Fed Chairman, Treasury Secretary, or any other financial regulator is next to impossible.

We now know that the New York Fed knew about problems with LIBOR four years ago, yet nothing was disclosed to Congress. So what else are the regulators hiding from Congress? It is foolish to think that regulators who knew of problems in the financial system and didn't react to them or bring them to the attention of Congress would do anything differently with larger staffs, larger budgets, or when meeting with other regulators as part of FSOC.

To those who say that government needs to do something to combat the financial crisis and that we need more regulation, I agree wholeheartedly, but not in the way they would expect. What government needs to do is get out of the way of the market, reduce the restrictions on competition in the financial sector, and reduce the restrictions on what individuals can do with their money. The regulation we need is market-based regulation, the rule of the market in which consumers, not government, are able to pick the winners and losers. Profitable firms are allowed to prosper and thrive in freedom from the government's chokehold, while unprofitable firms are refused bailouts and allowed to go out of business. Government subversion of the market process is what got us into the financial crisis, it is what is prolonging the crisis, and the only way out of the crisis is for government to get out of the way and legalize market freedom.