

Fannie, Freddie, and the federal takeover of everything else

Within the last several weeks, the federal government has infused massive amounts of public capital into private financial firms – from the investment bank Bear Sterns to the insurance behemoth AIG. In some cases, it has even taken on the management of entire companies, such as the quasi-private mortgage giants Fannie May and Freddie Mac.

The government's actions have been characterized in some quarters as unprecedented, and they have economists and policymakers puzzling over the ultimate outcome of the largest federal intervention in the private economy in decades. While astonishing to some, careful observers of history will not be surprised by these actions, for today's federal presence on Wall Street is just one facet of a much larger phenomenon – the federal government's gradual expansion into virtually every facet of American life.

A federalist – not federal – design

The current, pervasive scope of federal involvement in American society was not part of the vision shared by most delegates who attended the 1787 Constitutional Convention. The Constitution's design was not one of federal supremacy, but rather one of federalism – with limited, prescribed powers set out for the central government, and the rest left to individual states.

This design stemmed from concerns among many delegates that too much centralization would strip localities of decision-making power, and place too much authority in the hands of a single entity. Thus, a power-sharing arrangement with state government was crafted, and eventually ratified. Today, this federalist arrangement has been abandoned in many respects, and has been replaced by a centralized infrastructure whose powers and costs continue to escalate, while its accountability has diminished in many important regards.

To be sure, federal involvement in American life is not problematic in every instance. There are certain tasks that are well suited to national government – from defense, to the regulation of environmental standards across national industries, to the protection of civil rights against state infringement. The Constitution sets out many areas where the federal government is

empowered to act, and a certain amount of growth in the scope of its missions has been inevitable as our national life has grown increasingly complex. The rate of this growth, however, has far eclipsed anything contemplated by the Framers, and we now find ourselves at the point where America needs to revisit its one-sided relationship with federal power.

Crisis and growth

Throughout American history, moments of crisis have provided the surest catalysts for federal expansion. The Great Depression and the world wars of the 20th century acted to realign the role of the federal government in fundamental ways, by creating a panoply of federal agencies that remain with us to this day. Following closely behind, the years of the Cold War ensured that a large federal government would become a permanent feature of the American landscape, as wartime spending levels were used to maintain large defense and intelligence bureaucracies.

By the dawn of the Vietnam War, federalization had become a consensus concept in American politics, and the Johnson administration moved vigorously to involve the national government in scores of projects – from training local police to providing federal grants for arts projects. Johnson’s “guns and butter” approach to governance coupled large-scale domestic spending programs with military intervention in Vietnam, and created a significant federal deficit that has ebbed and flowed over time. Today, that deficit has reached nearly \$10 trillion, when adjusted to account for this month’s round of Wall Street bailouts.

Our recent history demonstrates that this pattern of crisis-stimulated federal expansion is alive and well. The past eight years – bracketed as they have been by the dual crises of 9/11 and the meltdown of the mortgage markets – have witnessed rapid federal growth in a number of areas. At the same time, other aspects of our national life have “gone federal” with little prompting, buoyed up by prevailing political currents that lead inexorably toward Washington. A few examples are cited below:

Homeland security

After the 9/11 attacks, Congress and the Bush administration engaged in a reformulation of national-defense priorities that was inevitable, and in some ways necessary. However, what emerged from this period was less a cohesive counterterrorism strategy than a collection of formerly cast-aside programs that had finally found purchase. For instance, domestic missions

for the U.S. military – long resisted by many in the Pentagon – were broadened in 2002 with the establishment of the U.S. Northern Command, or NORTHCOM. While initially described as a coordinating body for domestic disaster and counterterrorism response, NORTHCOM will now have a dedicated infantry combat team assigned to the United States. According to the Army Times, this unit will be outfitted with the Army’s “first ever non-lethal weapons package” for civil-disturbance control.

Americans have also long resisted the notion of a national identity document, preferring to let states set their own standards in this regard. However, 9/11 created tremendous momentum in the direction of a “national ID card,” to the point where Congress, in 2005, mandated national standards for state driver’s licenses under the “REAL ID Act.” These mandates – which include entering all REAL ID information into a series of interconnected databases – are costly to implement, and have little demonstrable benefit in increasing border security, according to critics. As security expert Bruce Schneider has also noted, the risks posed by identity theft and fraud greatly escalate due to the interconnected nature of REAL ID databases. Implementation of this program has been so unpopular in some states that several legislative bodies have passed resolutions opposing it.

Education

Education policy became a focus of renewed federal action in 2001 with the passage of the No Child Left Behind Act (NCLB). That year, a Republican Congress passed a Democrat-authored bill that established a high level of federal control over state and local educational policy. This control took the form of national mandates for the development of state testing standards for schools that accepted federal funds. Critics of NCLB have charged that the legislation effectively limits the flexibility of schools to set their own curriculum, due to the amount of class time spent on prepping for standardized tests.

Like the “REAL ID” program, No Child Left Behind has stoked growing resistance in statehouses across the country, with some states openly discussing the possibility of forgoing national matching dollars, rather than submitting to the federal requirements.

Federalism and the drug war

Recent years have also seen an increase in federal raids of “medical marijuana” clinics that are dispensing cannabis in accordance with their own

state laws. Despite the passage of medical marijuana bills by several state legislatures, federal agencies have continued to shut down marijuana clinics, even if they are transacting business entirely within their own state's borders. In this matter, the federal government got an assist from the *Gonzalez v. Raich* Supreme Court decision, which had been brought as a challenge to federal regulatory authority over medical marijuana.

Although the marijuana at issue in the *Raich* case was dispensed legally in California, and never crossed state lines (thus never entering "interstate commerce" and triggering federal jurisdiction), the *Raich* decision held that the federal government had the authority to regulate the purely intrastate use of marijuana, because the legal sale of cannabis in California impacted the broader national market for marijuana, thereby making it a matter of federal provenance.

Whatever one thinks of the merits (or nonmerits) of medical marijuana, the expansive logic of the *Raich* decision deserves additional public scrutiny because of the ramifications that it has for state-federal interaction.

Wall Street intervention

While the Constitution contemplates some federal involvement in the economy (such as coining money and setting its value), its role as a provider of bailout funds to private institutions is a significant expansion of its former, narrow role. The taxpayer-funded rescue scheme that Washington is now engaging in may or may not work in the short term, but it sets a worrisome precedent for the future, and comes with stakes that are extremely high.

Economists critical of the Wall Street rescue plan note that providing federal money to private firms removes the risk calculations that are supposed to make the private sector economy run efficiently. They likewise note that the removal of downside risks simply rewards bad behavior, and ultimately encourages more risk.

At the same time, the debt-driven financing model that the government is using to underwrite its bailout programs cannot sustain itself forever. According to critics, as the national debt becomes more intractable, U.S. Treasury bonds and other instruments that the government is using to finance corporate bailouts will become increasingly unattractive. This, in turn, may cause institutional and foreign capital to flee, leaving the nation

with no ability to spend its way out of this new problem.

This risky financial picture is emerging at a time when both major party candidates are proposing enormous amounts of new spending – either on the provision of a national health-care plan, or on the financing of more military intervention abroad.

Whoever captures the White House and Congress in November will take the helm of national institutions saddled with debt and burdened with extensive obligations. It will be up to state governments – and the American public – to help federal leaders redefine the role of the federal government, and to help guide it to a much more modest and sustainable future.

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