



## GOVERNMENTS GETTING INVOLVED: PUBLIC CONTROL OF THE INVISIBLE HAND OF THE MARKETPLACE

*“The government’s the enemy until you need a friend.”*

– William Cohen  
Former U.S. Senator (R), Maine

*“If you’re not confused, you’re not paying attention.”*

– Joseph Brusuelas  
Chief Economist, Merk Mutual Funds

*After looking askance at Japan, Inc., Russia, Inc., and China, Inc., for their government-business collaborations, Americans must now get accustomed to Fed, Inc., Washington’s bold move to entwine the government in the economy. The huge government intervention into the U.S. economy has made Washington a player in several financial arenas and brings the U.S. government in line with other sovereign states that have brought their economies under greater government control.*

*Washington has been moving toward government involvement in personal lives and even economic realities for some time, and recent examples of state and local government actions suggest that attitudes in the country are shifting about the role of government in economic matters. If only the enterprises that the U.S. government now manages could turn a profit the way the Chinese state-owned companies did last year.*

### **Fed, Inc.**

During the 1980s and after, market observers often spoke of “Japan, Inc.,” the massive enterprise of interlinked corporations and complementary government support that created the era’s economic juggernaut. Interestingly enough, Japan, Inc., lost its momentum after the collapse of that country’s real

estate bubble. More recently, we have made reference to Russia, Inc., the massive industrial enterprise of government control and industrial consolidation that has created a different kind of economic juggernaut for a different kind of era. Recently, Russia, Inc., has experienced financial trouble, not only because of military adventurism but also because of the worldwide unwinding of another real estate bubble. Between

the Japanese and Russian “incorporations,” observers have made reference to China, Inc., and to lesser examples of government-business collaboration, such as Korea, Inc. (see “Strategic Economic Deployment: As Russia Goes, So Goes (More and More of) the World,” **IF 2717**, 7/14/06).



Now we have Fed, Inc., the U.S. government’s foray into profit-making through the indenturing of large commercial enterprises – so far, Fannie Mae, Freddie Mac and American International Group (AIG) – and the purchasing of trick, market-toxic financial instruments. In short order, the U.S. Federal Reserve has gone from a government entity charged with monitoring the economy and managing short-term interest rates to a government entity with management duties for an insurance conglomerate, an investment bank, a mortgage holder and a marketer of derivatives. In providing funding to AIG, the Fed became a lending agency with margins approaching 8 percent. Despite the feel that “We, the people” have become the ultimate Wall Street “Greater Fools” by assuming massive amounts of private-sector debt, these new hybrid enterprises will, government officials insist, turn a profit for the people of the United States. That is, Fed, Inc. could well become a profit-taking enterprise. (*New York Times*, 9/18/08; *Atlanta Journal-Constitution*, 9/18/08)

One critical point makes the U.S. government’s venture into profit-making endeavors different from either Japan’s or Russia’s: The Fed’s aggressive

movement into business is not the result of a strategic, planned action intended to leverage the combined capabilities of the public and private sectors, as has been the case for Japan, Russia, Korea and China. Rather, the Federal Reserve’s actions look more like panic-driven responses to collapsing financial institutions. Russia has been nationalizing its oil and gas resources as prices have ascended, while the Fed nationalized Fannie Mae and Freddie Mac as they were losing nearly 90 percent of their market caps. (*USA Today*, 9/8/08)

Fed, Inc., shares at least one important feature with Russia, Inc.: Washington will make the newly owned enterprises profitable by exploiting the full power and authority of the federal government. Like Beijing, which just a few years ago pumped at least \$400 billion into China’s ailing banking system (prompting public rebukes from U.S. executives and officials), and like Moscow, which has recently been pumping tens of billions of dollars into Russia’s stock market, Washington, with its \$700-plus billion investment in U.S. financial institutions and various financial instruments, is becoming a direct manager of economic realities. (*New York Times*, 9/20/08)

Welcome to the brave new world of sovereign control and public power – a world in which governments are intricately entwined in the economy and where government officials feel justified changing the rules of the financial game whenever they deem it in their interests or in the interests of those deemed worthy of help (see “‘No Longer Operative’: Changing the Rule of Law and Other Surprising but Impactful Tactics in World War III,” **IF 2715**, 6/26/06).



## A Progression, Not a Lurch

Even though the U.S. Federal Reserve's actions seem to be giant leaps toward government involvement in concerns assumed to be heretofore non-government affairs, the progress toward such action has been developing for some time. The Bush administration has altered the role of government in private lives, granting various investigative agencies the power to use techniques once considered illegal and inappropriate. In one recent example, this month the administration issued a new policy granting domestic investigators greater latitude in determining if they can search property and monitor phone or online communications without seeking court permission. This kind of perspective easily progresses into the recent governmental decision to ban short selling in selected areas, all actions intended, at least rhetorically, to protect the public from one thing or another. (*New York Times*, 9/21/08)

Government rationale for acting to control personal or commercial activities has always been a mix of necessity and efficiency, an effort to guide or monitor risky behavior and to make it easier for officials to do their jobs. With recent actions to buttress and bolster the economy, Washington has taken another significant step forward based on necessity and efficiency.



But that significant increase in government involvement comes amid several government actions that suggest a changing role for government in economic and market affairs. The emerging attitude has recently surfaced in actions taken by state and local governments, as they increase their involvement in markets and behavior in ways they had dared not do in the past.

F In August, the Los Angeles City Council voted to impose a one-year moratorium on the opening of any new McDonald's, Burger King or other fast-food restaurants in the 32-square mile area called South Los Angeles. (*The Week*, 8/15/08)

F In August, the state of Alabama announced that it would require obese state employees who do not start losing weight to pay an additional \$25 per month for health insurance. (*Investor's Business Daily*, 8/27/08)

F In April, a federal appeals court agreed with New York City that it had the authority to require chain restaurants to post publicly the calorie content of the food items they sell. (*Wall Street Journal*, 4/30/08)



These are government actions directed at cutting the government's own costs for health insurance. Los Angeles is experiencing a rapid increase in the number of citizens who are either obese and/or suffering from diabetes. This eventually puts pressure on public hospitals, especially if the patients do not have health insurance. Alabama officials note that employees with a body mass

index (BMI) between 35 and 39, designated as obese, cost \$1,748 more in annual medical expenses than someone with a normal BMI. Meanwhile, New York City has insisted consumers have a right to know the caloric content of what they buy and eat, under the assumption that they will control their intake if they understand its impact. But health-care costs are not the only issues that local governments have lately considered important enough to take action to control.

Three California cities – Manhattan Beach, Malibu and San Francisco – have banned the use of petroleum and bio-based plastic carry-out bags. Los Angeles will pass a similar bill if the California legislature, which is considering a state-wide ban, does not take action. Rhode Island and New York legislatures have bills pending to do the same, while New Jersey and Pennsylvania legislatures are considering the mandatory recycling of all plastic bags. Overall, 100 different jurisdictions, both state and local, are considering controlling the use of plastic bags in some ways. (*Plastics News*, 7/7/08)

As with health care, litter and trash collection are expensive services for local governments. Efforts to manage those costs have led many governments to take control of the situation. In doing so, more and more governments are deciding that they need to be more involved in pushing the changes that officials believe society needs to make but that markets may not encourage.



## A Widening Perspective

These governmental actions are not yet equal to the way governments stay involved in societal activities elsewhere – say, in Europe. One contrast suggests the difference. The Berkeley (CA) City Council recently passed a policy whereby the city government would finance any citizen's purchase of a solar-energy unit. The loan from the city to fund the purchase would be amortized over 20 years and paid in increments through each household's monthly energy bill. Meanwhile, in Europe, the city council of Marburg, Germany, took a much more aggressive stance, actually passing an ordinance **mandating** that all citizens purchase a solar energy unit when building a new home or remodeling an existing one. Challenges to that ruling are still in court. (*International Herald Tribune*, 8/8/08)

Despite these kinds of cultural differences, the new activism by state and local governments in the U.S. does signal a changing attitude among citizens about the role of government. Seen by most citizens as bad since the 1980s, government involvement in the economy and elsewhere is gaining new approval, as situations become dire and aggressive actions are seen as necessary.

In a *Briefing* last year, we noted that regulators had turned their attention to those who were gaming markets and that this new attention was expanding some areas of regulation. Manipulating the rules the way several individuals in the financial community had done was requiring government to increase its scrutiny of those financial actions, and governments seemed ready to increase its monitoring, even going so far, as the federal government did after our *Briefing*, to make selling certain stocks short illegal (see "Gaming Gets Exposed: Regulation and Society's Movement Toward Accountability," **IF 2810**, 4/12/07).

Since then, the financial crisis has spread past individual gaming tactics to enterprise-wide collapses and rolling financial failures triggered by institutional investment strategies that once seemed brilliant but now seem naïve and suicidal. When several major financial brand names teetered on the brink of failure, the federal government found itself moving from regulator to owner in its efforts to stop what, for three years, we have called the **economic tsunami**.

At the same time, many local governments are realizing that the "invisible hand of the marketplace"

seems to be increasing their operational costs, whether in paying more money to insure the obese or in simply picking up the trash of a high-waste society. Given that revenues to these local governments have been declining because of the real estate collapse, governments need to take action that will alter society's behavior – and their obligations.



The spreading attitude that favors government involvement in society's finances and behavior befits the set of attitudes we have associated with the Next American. In an earlier look at these emerging attitudes, we noted that the value set associated with the Next American favors **interdependent** rather than **individualistic** action and "prefers solutions that start at the societal rather than the individual level... Interdependence will come easier because the problems that society faces and that need attention cannot be addressed effectively by the individual alone" (see "The Next American: Changes in Attitude and Style Among Consumers, Employees and Citizens," *IF* 2905, 2/29/08).

Many different kinds of organizations and institutions – from unions to non-governmental organizations – will benefit from this emerging perspective. As we discussed in the earlier *Briefing*, the U.S. Army is undergoing a major revision in the kinds of

behavior it seeks to reward because the kinds of global conflicts it now confronts no longer succumb solely to "take the hill" combat. The new Army will now reward soldiers who demonstrate skills in cultural connections with local citizens as well as peacekeeping and reconstruction operations.

The military has an advantage over most societal institutions in its ability to effect change: It has a fairly rigid top-down structure that can make change happen. For non-military society, the leverage that governments can apply on society as a whole will seem more and more attractive in this new era, precisely because government is powerful enough to force changes that the economy and many industries need but might not find "profitable" in the short term. Also, government participation in the economy will become even more attractive if the governmental enterprise can turn a handsome profit.

That last item could be one outcome Fed, Inc., might want to emulate from China, Inc.: In 2007, the 150 Chinese state-owned companies made a profit of \$140 billion. Having turned their attention to saving the public money over the long term by seeking to control some kinds of behavior, U.S. governments at all levels would certainly win approval if they could turn a profit for the public – that would ease historical anxieties over governments getting involved.

