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HD **Unraveling Reagan: Amid Turmoil, U.S. Turns Away From Decades of Deregulation**

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LP WASHINGTON -- The housing and financial crisis convulsing the U.S. is powering a new wave of government regulation of business and the **economy.**

Federal and state governments alike are increasingly hands-on in their effort to deal with failing businesses, plunging house prices, worthless mortgages and soaring energy prices. The steps add up to a major challenge to the movement toward deregulation that has defined American governance for much of the past quarter-century since the "Reagan Revolution" of the early 1980s. In fact, some proponents today of a bigger oversight role for government are Republican heirs to the legacy of President Reagan.

TD On Thursday, the government's role in policing the financial markets took center stage at a House Financial Services Committee hearing. In testimony there, Securities and Exchange Commission Chairman Christopher Cox said the SEC should be given more power to regulate the parent companies of investment banks, and New York Fed President Timothy Geithner described the need for policy makers to be particularly vigilant, noting the entire regulatory structure should be reevaluated. "You have to be prepared to look at everything," he said. Both men testified how government regulation can be strengthened without stifling financial innovation.

Already, the Federal Reserve has dialed up its scrutiny of Wall Street investment banks, placing officials inside the giant firms and weighing in on their capital requirements, after taking the unusual step of offering tens of billions of dollars in emergency loans. The Fed has also agreed to lend money to Fannie Mae and Freddie Mac, potentially giving the agency more oversight of the two giant housing-finance companies as well.

At the same time, state **utility** commissions are re-establishing control over power companies that they ceded during earlier waves of deregulation. The Education Department is taking a step toward nationalizing the market for student loans, after private lenders abandoned that business.

The debate over Washington's hand in the **economy** is at the heart of the presidential campaign. Both major-party candidates are endorsing proposals to create new, Federal Reserve-style commissions to limit greenhouse-**gas** emissions and decide how to spend billions of dollars on energy-efficient technology.

"There's a backlash against the laissez-faire, 'isn't-it-wonderful-how-creative-markets-are' viewpoint," says former Fed Vice Chairman Alan Blinder, a Democrat. "Markets are creative, but sometimes the creativity leads to strange and dangerous directions."

Alabama Sen. Richard Shelby, the top Republican on the Senate Banking committee, notes the shift in power away from markets, but worries about the result. "It's in the wrong direction, from my point of view," he says.

Public opinion is shaping the response. By a 53%-to-42% margin, Americans want government to "do more to solve problems," according to a Wall Street Journal/NBC News poll released Wednesday. A dozen years earlier, respondents opposed government action by a 2-to-1 margin.

There is a possibility the shift will be temporary. Kevin Hassett, a conservative economist at the American Enterprise Institute, says there have been other times when an era of activist government appeared to be dawning, but didn't. After the savings-and-loan system collapsed in the 1980s, the government spent $125 billion seizing failed S&Ls and selling off their loans. But that didn't augur a return of bigger government. President Clinton's effort to create a universal health-care system in the 1990s flamed out.

Critics "are insinuating there are fundamental problems with laissez-faire economics," says Mr. Hassett. "It's just insinuation."

Even if activism is on the rise, it doesn't mean a rollback of decades of deregulation of businesses ranging from airlines to trucking to telecommunications. Those moves have lowered the cost of goods and services across the **economy.**

The degree of change will depend on who occupies the White House next January. Sen. Barack Obama, the presumed Democratic candidate, has talked about a sharp increase in taxes on wealthy Americans, and a windfall-profits tax on oil companies. Republican rival Sen. John McCain would cut taxes on corporations.

Still, powerful industries are facing greater pressure for regulation than they've seen in a generation because of concerns about the safety of the products. Drug makers are being pressed by congressional Republicans and Democrats alike, who want stricter oversight by the Food and Drug Administration and new regulations that would mandate tougher safety standards and import controls.

In the case of the food industry, the food processors and other companies -- fearing a public backlash -- have been urging Washington to ratchet up its oversight of imported foods and ingredients, reversing the industry's usual hands-off approach. While the Bush administration hasn't been willing to go as far as the processors want, Florida recently imposed requirements on tomato growers for annual inspections, among other measures.

The bigger role for government is being driven in part by fallout from the housing crisis. The beating suffered by financial institutions has required the kind of quick, large-scale financial intervention that only the Federal Reserve can provide. At the same time, the success of the Fed in recent years at whipping inflation and limiting the depth of recessions has had the side effect of enhancing the reputation of government agencies. That's prompting politicians to try to use that model to solve other problems.

It all adds up to more government activism, but an activism that relies more heavily on unelected bureaucrats rather than elected lawmakers. In coming years, the big issue will be "where should we draw the line between the political and the technocratic," says Mr. Blinder, the former Fed vice chairman.

This nuanced view is reflected in the proposals of the presidential candidates. Sen. Obama wants a big push in spending on bridges, ports, railroads and other infrastructure, but worries about politicians doling out the money according to political whim. (That danger is also a long-time concern of Sen. McCain.) To insulate the spending, he would create a $6 billion bank patterned on the Federal Deposit Insurance Corp., which has five members whose terms are staggered to try to assure political independence.

Sen. McCain has said he is open to a bailout of General Motors Corp., if it were threatened with bankruptcy amid falling sales and high costs, and wants to direct federal funds to develop new-generation automobile batteries and **electric** cars. "There's always a basic issue about what is the way to effectively harness private markets," says McCain policy chief Douglas Holtz-Eakin.

The struggle between markets and the government is as old as the country itself. Founding Father Alexander Hamilton pushed for higher tariffs to protect nascent U.S. manufacturers, saying he wanted to preserve "a monopoly of the domestic market." That directly clashed with the get-the-government-off-our-back agrarianism of Thomas Jefferson.

Since then, various crises have sent the pendulum swinging back and forth. The handling of the financial panic of 1907 -- when a private individual, banker J.P. Morgan, bailed out a floundering U.S. **economy** -- stirred so much political outrage on the left that in 1913 the government created the Federal Reserve to run the financial system. The Depression-era collapse of markets led to the birth of a slew of new agencies, including the Securities and Exchange Commission and the Federal Deposit Insurance Corp., which regulated and remade American-style capitalism.

Disgust at bungling government policies that by 1980 produced a combined rate of inflation and unemployment of 20% -- the "misery index" -- led to the election of Ronald Reagan. He rolled back regulation and antitrust enforcement as a way to free market forces from the shackles of government.

The movement started by President Reagan has taken several hits. The 2001 terror attacks led to the nationalization of airport workers and the creation of the elephantine Homeland Security Agency, bucking decades of privatization of government functions. The corporate-accounting scandals early this decade that leveled energy trader Enron and communications giant WorldCom led to the Sarbanes-Oxley law in 2002, which reversed the pattern of the prior two decades of easing regulation of U.S. companies. Among that law's many provisions, chief executives had to accept legal responsibility for the accuracy of their firms' financial statements.

On the state level, California regulators clawed back as much control as they could of the state's electricity market after a failed experiment in deregulation that started in 1998. "Excesses by markets bring the pendulum swinging back toward government," says Michael Peevey, the Democratic president of the California Public Utilities Commission.

Activism shifted into a higher gear after 2006, when Democrats won control of the Congress and the **economy** was battered by higher fuel prices and falling housing values. The Democratic leadership has pushed President Bush into halting shipments into the government's 700-million-barrel Strategic Petroleum Reserve -- and is now pressing him to try to drive down prices by tapping the stockpile.

"Free our oil, Mr. President," said House Speaker Nancy Pelosi in a recent House debate. That gambit so far hasn't won White House backing.

Now some Bush regulatory appointees are moving aggressively to take charge. For more than a year, FDIC Chairman Sheila Bair used the bully pulpit to encourage lenders to act more forcefully to help homeowners avoid foreclosure. Her speeches had little effect -- but the recent failure of IndyMac Bank is now giving her the power to carry out her ideas.

Immediately after the FDIC took control of IndyMac on July 11, she suspended all foreclosures-in-progress for the $15 billion mortgage portfolio directly controlled by the bank. Now she is trying to modify the terms by moving adjustable-rate loans into fixed-rate mortgages.

With many other banks expected to fail because of mortgage defaults, she's likely to have other chances to put her ideas in practice. She also hopes other banks will follow the FDIC's prescription themselves, if necessary. "I think we can lead by example," says Ms. Bair, a Republican who was nominated by President Bush to a five-year term in 2006.

The Fed itself has seen the biggest accumulation of power, as Fed Chairman Bernanke and Treasury Secretary Hank Paulson, two Republicans, try to cope with the deepening economic problems. In mid-March, the Federal Reserve put $29 billion on the line to support the sale of Bear Stearns Cos., a huge investment bank that had begun to collapse and was forced into a shotgun marriage with J.P. Morgan Chase & Co.

The Fed is also lending money to four large investment banks. It has placed people inside those banks to scrutinize their holdings and capital -- an extraordinary step, given that the Fed doesn't have direct authority over the companies. On July 13, the Fed also agreed to lend money to Fannie and Freddie Mac, the two biggest mortgage-finance companies, prompting lawmakers to push for a bigger Fed role in monitoring the companies' soundness.

Though the steps have been viewed as temporary, Mr. Bernanke said this month that the central bank's lending powers to investment banks could last more than the six months originally envisioned.

Other government agencies are playing expansive roles, too. The Treasury Department is seeking congressional approval to buy equity stakes in Fannie Mae and Freddie Mac and offer them unlimited lines of credit to prevent the companies from collapsing. The Federal Housing Administration has eased standards for government-insured mortgages.

Critics warn that turning power over to technocrats can lead to trouble. "The best and the brightest" of the Kennedy and Johnson administrations escalated, and then lost, the war in Vietnam. Federal and state officials still haven't rebuilt New Orleans and the surrounding area three years after Hurricane Katrina struck.

The Fed's reputation for independence could suffer if it is handed a larger regulatory role over banks and could produce a conflict of interest. If economic conditions call for the Fed to, say, raise interest rates to control inflation, would the Fed hold off because those higher rates could hurt the banks it regulates?

Former House Republican Speaker Newt Gingrich, who captained the Republican takeover of

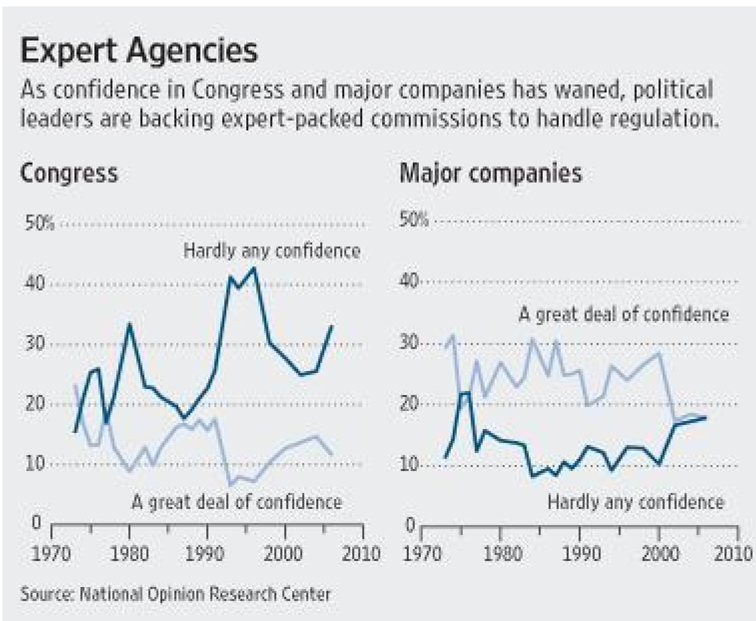
Congress in 1994 on a "small-government" platform, figures that any surge in government activism is bound to be short-lived because bureaucrats will blunder. "It's very dangerous to assume that some skill at managing the money supply [as the Fed has done] will lead to bureaucratic skills greater than any country possesses," he says.

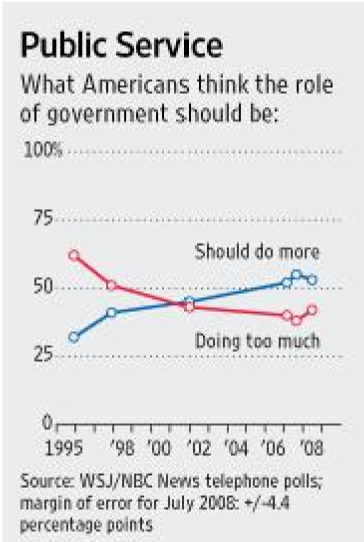
Dealing with global warming may augur a further expansion of government power. The leading proposal in Congress would cap emissions of greenhouses gases by industries and allow them to buy and sell emission permits.

The legislation garnered 48 votes in the Senate in a June procedural measure, leaving it a dozen short of the 60 needed to get a vote on the bill. Both presidential candidates have made emissions-trading systems a centerpiece of their environmental platforms, all but assuring another congressional effort after the election.

"Markets are groping" for guidance, says Fred Morse, a senior adviser to the U.S. solar-power subsidiary of Spanish **utility**Abengoa SA. "You need government to lay out a policy."

Stephen Power, Greg Hitt, Kara Scannell and Yuka Hayashi contributed to this article.





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