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The Financial Crisis Was A Failure Of Government, Not Free Markets

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The now-famous (infamous?) "financial crisis" began five years ago (September-October 2008), in the middle of the so-called "Great Recession" (December 2007 – June 2009). This is more than enough time to gain perspective, collect the evidence, apply some logic, and achieve a valid conclusion, so such crises won't recur in the future.

Good luck with all that. Don't hold your breath. After five years, thousands of misguided articles, and dozens of poorly-researched books, many people – especially the financial journalists and professional economists among us – still don't "get it." Many people still attribute the financial crisis of 2008 to "greed," Wall Street, and free-market capitalism, even though the *real* cause –which has yet to be acknowledged, let alone removed – was *government intervention* in markets. This included the Federal Reserve's disruptive manipulations of interest rates, plus massive subsidies and regulations in housing, banking, and mortgages. For years government policy promoted reckless financial practices (*aka*, "moral hazard") and then made things *worse* by bailing out the worst miscreants.

I've offered my own assessments, and, obviously, I consider them valid. Decide for yourself. In spring of 2009 I gave a contrarian, comprehensive n account of the crisis – both its origin and extent – but I also explained how the deeper problem was a type of public policy-making that enshrines and institutionalizes *need* over greed. Policy priority and favoritism went to those most in *need* of homes they couldn't afford and in *need* of loans they couldn't repay. Sounds "noble," but it really isn't. We've all been taught since childhood to cater to those who suffer and are in

dire need, as a moral "duty," and in the words of Finley Dunne, to "comfort the afflicted while afflicting the comfortable." But this approach hardly undergirds free, well-functioning markets. Indeed, it subsidizes recklessness and eventually afflicts *everyone*. "Need" isn't a standard that a rational, free-market banker would abide, but it's one that's eagerly exploited by those backed by *other* people's money: the Fed, FDIC, FHA, Fannie Mae, or Freddie Mac. By the way, those are *government* agencies, not free-market institutions, and deserve the main blame.

All these culpable government agencies still exist, and if anything, have been given even *more* funding and power than they had *before* 2008, due in large part to the Dodd-Frank Act (2010), legislation co-sponsored by the two politicians (now out of office) who were most in the pay of Fannie and Freddie, and most responsible also for the policies that triggered the mortgage crisis of 2008-2009. Amazingly, no prominent politician or policy-maker in Washington ever went to jail or was even fired from his job for such egregious malpractice and peculation. A recent *Wall Street Journal* account says that Fannie and Freddie remain "unfinished business, "as if reformers have these agencies in the cross-hairs. But what reform plan dares to really finish them off, for good? None I'm aware of.

There is, of course, a rational way out of this sordid mess, as I offered in March 2012, in a Forbes.com essay titled **"Five Financial Reforms That Would Prevent Crises and Promote Prosperity."** But don't expect financial reformers to bother adopting any of what I advise. My reforms would restrict or phase out the Fed, FDIC, FHA, Fannie Mae, and Freddie Mac. Any takers? Despite all the damage these interventionist agencies have inflicted, and regardless of the ease with which free market alternatives can be fashioned and fostered, the agencies are still viewed as sacrosanct and untouchable (except with more funding and power). Thus future crises are inevitable.

A recent study by the American Enterprise Institute – titled "Five Years After the Crash: What Americas Think About Wall Street, Banks, Business and Free Enterprise" – isn't very heartening, at least if you're a pro-capitalist. "The persistent lack of trust in Wall Street five years after the crash suggests that many Americans have deep misgivings about the operations of the financial sector," the study concludes, and "the consensus is that many of these firms are not ethical or concerned about the well-being of the country." Only 65% of those polled by AEI

reported having a positive image of capitalism, while 31% have a negative view of it. "Large majorities have long told pollsters that Wall Street is greedy, selfish, and unethical," says AEI. Self-interest is . . . immoral? So self-sacrifice and misery are moral ideals? In fact, when guided by reason and the long-range view, self-interest is both moral *and* practical: greed for knowledge, wealth, health, culture, and well-being is the motivation for achievement and prosperity. Greed doesn't mean exploiting others but *trading* with them, *value-for-value*, to*mutual* advantage.

What fuels demand for ever-more financial regulation is this basic mistake about the ethics of greed. According to the AEI study, "the current disapproval of Wall Street stems from something deeper than the crash and economic downturn. Americans' concerns about Wall Street arise from doubts about the moral bearings of people who work there. As long as Wall Street is seen as unethical, greedy, and possibly corrupt, American will continue to worry about the capacity of large financial institutions to derail the economy." In short, people blithely presume that those working in banking (or finance, broadly) are "immoral" *because* they are self-interested, and that this "immorality" must invariably cause disastrous economic results, on occasion, even though nearly everyone *else*, in nearly every *other* field, presumably also pursues a self-interest. Why are the non-bankers not *also* "corrupt?" What explains the specific, prejudicial bigotry trained on banking? And if banking is "inherently" corrupt, why do voters keep electing politicians who insist on *subsidizing* bad banks with cheap deposit insurance and crony-style bailouts?

I've read many articles and books on the financial crisis of 2008-2009, but only one account gets both the diagnosis and prescription just right: John Allison's book, *The Financial Crisis and the Free Market Cure: Why Pure Capitalism is the World Economy's Only Hope* (McGraw-Hill, 2013). A long-time CEO of BB&T Corp., one of the nation's most ethical (self-interested) and thus successful banks, Mr. Allison has been president of the Cato Institute for the past year. You must read his book closely if you are to understand *what* happened five years ago, *why* it happened, and why it'll happen *again* unless interventions are removed. I'll say more about the book in a future Forbes.com essay, but for now just buy it – and read it honestly, carefully. It'll more than repay your efforts.