

Liar loans flourish; a stronger nation?

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In a Wall Street Journal guest opinion, Gerald O'Driscoll, a senior fellow at the Cato Institute and a former vice president for both Citigroup and the Federal Reserve Bank of Dallas, warns in "An Economy of Liars" that "when government and business collude, it's called crony capitalism. Expect more of this from the financial reforms contemplated in Washington." Based on his experience, he knows of what he speaks. Read it online at www.wsj.com:

Free markets depend on truth telling. Prices must reflect the valuations of consumers; interest rates must be reliable guides to entrepreneurs allocating capital across time; and a firm's accounts must reflect the true value of the business. Rather than truth telling, we are becoming an economy of liars. The cause is straightforward: crony capitalism.

Thomas Carlyle, the 19th century Victorian essayist, unflatteringly described classical liberalism as "anarchy plus a constable." As a romanticist, Carlyle hated the system - but described it accurately.

Classical liberals, whose modern counterparts are libertarians and small-government conservatives, believed that the state's duties should be limited (1) to provide for the national defense; (2) to protect persons and property against force and fraud; and (3) to provide public goods that markets cannot. That conception of government and its duties was articulated by the Declaration of Independence and embodied in the U.S. Constitution.

Modern liberals have greatly expanded the list of government functions, but, aside from totalitarian regimes, I know of no modern political movement that has shortened it. While protecting citizens against force, both at home and abroad, is the government's most basic function, protecting them against fraud is closely allied. By the use of force, a thief takes by arms what is not rightfully his; he who commits fraud takes secretly what is not rightfully his. It is the difference between a robber stealing brazenly on the street and a burglar stealing by stealth at night. The result is the same: the loss of property by its owner and the disordering of civil society. And government has failed miserably to perform this basic function.

Why has this happened? Financial services regulators failed to enforce laws and regulations against fraud. Bernie Madoff is the paradigmatic case and the Securities and Exchange Commission the paradigmatic failed regulator. Fraud is famously difficult to uncover, but as we now know, not Madoff's. The SEC chose to ignore the evidence brought to its attention. Banking regulators allowed a kind of mortgage dubbed "liar loans" to flourish. And so on. ...

If we want to restore our economic freedom and recover the wonderfully productive free market, we must restore truth-telling on markets. That means the end to price-distorting subsidies, which include artificially low interest rates. No one admits to preferring crony capitalism, but an expansive regulatory state undergirds it in practice.

Piling on more rules and statutes will not produce something different than it has in the past. Reliance on affirmative principles of truth-telling in accounting statements and a duty of care would be preferable. Deregulation is not some kind of libertarian mantra but an absolute necessity if we are to exit crony capitalism.

In "Everybody Loves a Winner," New York Times columnist Thomas Friedman says that, "In politics and diplomacy, success breeds authority and authority breeds more success. No one ever said it better than Osama bin Laden: 'When people see a strong horse and a weak horse, by nature they will like the strong horse.'" Read it online at www.nytimes.com:

Have no illusions, the rest of the world was watching our health care debate very closely, waiting to see who would be the strong horse - Obama or his Democratic and Republican health care opponents? At every turn in the debate, America's enemies and rivals were gauging what the outcome might mean for their own ability to push around an untested U.S. president. ...

It remains to be seen whether, in the long run, America will be made physically healthier by the bill's passage. But, in the short run, Obama definitely was made geopolitically healthier. While Obama's health care victory prevented a power outage for him, it does not guarantee a power surge. Ultimately, what makes a strong president is a strong country - a country whose underlying economic prowess, balance sheet and innovative capacity enable it to generate and project both military power and what the political scientist Joe Nye calls "soft power" - being an example that others want to emulate.

What matters most now is how Obama uses the political capital that health care's passage has earned him. I continue to believe that the most

important foreign policy issue America faces today is its ability to successfully engage in nation building - nation building at home.

Obama's success in passing health care and the bounce it has put in his step will be nothing but a sugar high if we can't get our deficit under control, inspire a new generation of start-ups, upgrade our railroads and Internet and continue to attract the world's smartest and most energetic immigrants.

An effective, self-confident president with a weak country is nothing more than a bluffer. An effective, self-confident president, though, at least increases the odds of us building a stronger country.

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