CNSNews.com

# Free Market Economists Reject Bailout as Bad Policy that Could Prolong Slowdown

**Wednesday, October 01, 2008**

By Matt Cover

**(CNSNews.com) –** The federal government created the current financial crisis, and unless it does some serious housekeeping, no amount of bailout money is going to solve the problem. That's what some free market economists and experts said when **CNSNews.com** asked them about the proposed bailout plan that was rejected Monday by the U.S. House of Representatives.

The problem with the plan is that "it was a bailout," said Sheldon Richman, editor of *The Freeman*, a free market journal. "It's the government swooping in and buying rotten loans from banks (that) made bad mistakes."

The bailout's proposed $700 billion price tag was only "a minimum," according to Richman, who claimed the bailout failed because "the taxpayers were innocent in this and yet they were going to be forced one way or another to pay for these mistakes."

Richman said that instead of bailing out failed financial institutions, Congress needs to end the bad housing policies that caused the crisis in the first place – a remedy that was echoed by other economists, including professor Jake Haulk of the Allegheny Institute for Public Policy.

"It wasn't Wall Street that created these guaranteed mortgage-backed securities; it was Fannie Mae and Freddie Mac acting as adjuncts of the government – and they are to blame," Haulk told **CNSNews.com**.

"You don't get a crisis of this magnitude unless there was very heavy government involvement somewhere," he said, adding that serious reforms are absent from the current proposal.

Another major problem with the bailout, Richman noted, was that it allowed the Treasury Department to assume up to $700 billion in debt *at any one time*, not just in total. This meant that "it [the Treasury] could buy $700 billion worth of securities, get rid of them, sell them at market rates to private investors, and go out and buy another $700 billion [worth of securities]."

Duquesne University professor James Burnham echoed this sentiment, saying that because "there are so many uncertainties as to how it's going to be implemented," it was no wonder that many congressmen voted against the bailout.

Burnham, a former commercial banker and Federal Reserve Board member, said the bailout bill's failure was "unfortunate" because "something needs to be done." Some form of assistance will be necessary to mitigate any "collateral damage" that is done to small businesses and responsible borrowers hit hard by the credit freeze, he said.

Professor Iwan Azis of Cornell University agreed with that assessment, saying that the main reason why the plan did not pass was because of the uncertainty – taxpayers thought they would suffer “a big loss” if it turned out not to work.

“(That’s) precisely the main reason why it didn’t pass,” Azis said, “Everybody agreed that this theoretically should pass, to save the entire economy.”

Economist Thomas DiLorenzo of Loyola College, meanwhile, called the bailout “exactly the opposite of what we need to have.” One major problem, he said, is that it would delay an economic restructuring that “just has to happen.”

“(It) just has to happen, or we’ll never get out of this [economic] mess,” DiLorenzo said.

He criticized the bailout for creating a system where “profits are privatized and losses are socialized.”

Such a system removes market discipline, according to Richman, which only encourages bad business practices and increases the likelihood that businesses will take unsafe risks that lead to failure.

“Intervention is at the root of the problem,” Richman said, but the government “won’t even acknowledge there is a problem [with intervention].”

Democrats, he added, are especially at fault, because they opposed any attempt at reforming Fannie Mae and Freddie Mac.

“It was the Democrats who stood in the way,” Richman said, “because they thought that this might somewhat trim the sails of Fannie and Freddie and [then] they couldn’t use them for their social programs.”

That the bailout proposed unprecedented new types of intervention was one of its greatest flaws, the experts agreed.

One proposal allowed the secretary of the Treasury to approve “reasonable requests” from companies getting bailouts to alter mortgage terms, reduce interest rates, reduce or “write down” the loan’s principle amount or removal limits such as adjustable interest rates.

Richman characterized intervention on this scale as the government acting like “a bull in a china shop,” adding that “markets are too complicated for a planner, this is why central planning always fails.”

DiLorenzo called giving the government the authority to change loan terms “a crazy idea.”

“When government intervenes like this, it delays this whole process [of recovery] and will guarantee that we’ll have a volatile and declining economy for a much longer period of time,” he said.

DiLorenzo said the government bailout amounts to “the nationalization of the housing industry and the mortgage industry" – which he called socialism.

"There's no reason to believe that we can be better at it (socialism) than the Russians were," DiLorenzo added.

Other provisions, such as one allowing the government to hold warrants for non-voting stock in companies being bailed out, met what he called "the old-fashioned definition of socialism" – and would be "the ruination" of those companies, because "the government will always want to run these companies according to political criteria."

Another "bad policy" would expand the type of asset the government is allowed to buy from mortgage-backed securities to any troubled assets – even assets the Treasury Secretary finds must be purchased to "promote financial market stability."

This policy, DiLorenzo said, would effectively "appoint the Treasury Secretary as economic dictator," because he alone would have the power to determine what assets must be bought.

"Since when is the government such a great investor and entrepreneur?" he asked. "They're not even playing with their own money."

DiLorenzo said the government's record of deficit spending proved it couldn't be trusted to make good financial decisions that might return money to the taxpayer.

Bailout or no bailout, all of the economists interviewed told **CNSNews.com** that the federal government must end its policy of promoting low-cost and low-income mortgage lending if it is to truly solve the current crisis.

"What they should do is prohibit 100-percent, no-money-down mortgages," Burnham said. "They [Congress] pushed Fannie Mae, Freddie Mac, and the commercial banks for that matter, heavily into this affordable housing finance."