Governments, free markets, and the financial crisis

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Politicians worldwide are running for cover as their machinations have led to the mother of all crises.

Australian Prime Minister, Kevin Rudd, is reported to have declared that the 'comprehensive failure of extreme capitalism' has required government to step in to stem the damage. He blames the meltdown on failures in lending standards, risk management and corporate governance by the world's major lending institutions.

No, Mr Rudd, you've got it wrong. Dig a little deeper and you'll find that the debacle resulted entirely from the interference of the US government in the functioning of markets. Either you haven't studied the problem properly, or you're attempting to fool the citizens of Australia.

Walter E Williams, professor of economics at George Mason University in the US, in his article A minority View: Lessons from the Bailout, says the problem started with the enactment of the Community Reinvestment Act of 1977. This Act was then made more punitive during the Clinton presidency. Congress subsequently used the legislation to put pressure on banks to make high-risk loans to homebuyers and businesses that did not meet the banks' normal lending criteria. The encouragement offered by Congress was that the government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae would purchase the 'subprime' loans and rid them of the non-market risks they would incur in the process.

In order to take on huge quantities of these high-risk loans to low-income Americans who did not qualify for loans in the ordinary course of banking business, Freddie Mac and Fannie Mae 'securitised' the loans, which meant packaging a large number of them and selling the toxic packages on into the financial markets. Although the GSEs, which started life as government owned enterprises, were ostensibly privatised, owned by shareholders and traded on the New York Stock Exchange, they were not viewed as totally private.

A 2004 paper on the US postal services commented that, 'Real-world experience with Government Sponsored Enterprises (GSEs) like Fannie Mae and Freddie Mac demonstrates that lenders would still believe a federal credit guarantee exists, albeit an implicit one.' Fannie Mae still says on its website, 'Fannie Mae is a government-sponsored enterprise (GSE) chartered by Congress with a mission to provide liquidity and stability to the US housing and mortgage markets.' Does that sound like the statement of a private company?

Professor Williams suggests that as politics will probably not allow for the clean-out that should occur by bankruptcies and liquidations, the next best option is Congressional hearings to determine responsibility for the crisis caused by the GSEs and the prosecution of those found responsible for unlawful actions and fraud. He points out that the 'Enron and WorldCom debacle is a drop in the bucket compared to the financial mess that Congress has created through Fannie Mae and Freddie Mac in the name of "affordable" housing' but there is total silence about Congressional hearings regarding this massive scandal that is having worldwide repercussions.

No, Mr Rudd, the current financial mess is the result of comprehensive government failure resulting from reckless intervention in financial markets by the American Congress. Despite protests that Congress was allowing investors to believe that Fannie Mae and Freddie Mac were supported by an implicit federal credit guarantee, nothing was done to disabuse the investing public of that notion. The so-called 'greedy' bankers and investors made the fatal error of trusting the politicians that created and protected the 'hole in the dyke' that has led to the bursting of the dam wall, resulting in a flood that looks set to drown the world's financial systems.

Unfortunately, even if the world's politicians manage to stem the current tide by using their ability to create debt at the expense of future taxpayers, another hole in another dyke goes unmentioned: the accumulation of paper money 'backed by nothing' created by government-controlled central banks. The subprime debacle might be the immediate cause for concern, but it is merely a symptom of a greater and more fundamental problem; government monopolisation of money and the reckless abuse of that monopoly.

Printing excessive quantities of money has become standard practice along with manipulation of interest rates in attempts to retard the resultant price increases or avoid recessions, creating regular booms and busts. The subprime debt is merely the tip of the iceberg. The real problem is unsound money, a problem that is, in the long run, being made worse and not better by the great gobs of it being created out of thin air in attempts to stabilise the current situation.

Money is supposed to be a medium of exchange and a store of value, not a political football to be kicked about by politicians in their efforts to get elected or stay elected. Its function is so difficult to understand that when government-appointed central bankers rob savers by debasing the currency, the victims do not know what is happening to them. However, as the subprime event has shown, breaking economic laws is dangerous, and the perverse situation created by abusing the monopoly to print money will, if escaped this time, come back to bite us all even harder next time around.

Governments are responsible and yet they are attempting to shirk accountability for the world financial crisis. In doing so, they and sundry supporters are trying to pin the blame on ‘capitalism’ or ‘free markets’ instead of on their own interventions, many of which, as in the case of the subprime loans are based on socialist ideas. The statements they are making are plain wrong to the extent of being ludicrous. Citizens of all countries should strenuously resist the probable attempts by governments to increase their grip on financial markets through legislation and bureaucratic regulations to ‘protect’ the people from the supposed ‘failures’ of private markets. In doing so, they should insist on close scrutiny of the consequences of the current socialistic control over money and financial markets.

In time, governments will have to relinquish their money monopolies in order to allow fully accountable private banks to provide citizens of the world with competitive private currencies – money that does not constantly lose purchasing power and cause persistent crises.

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