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## **Obama's Uninformed Optimism** **by Sheldon Richman**

President Obama is optimistic that “We will rebuild, we will recover, and the United States of America will emerge stronger than before.” That and \$5 will get you coffee at Starbucks — until inflation kicks in.

In his appearance before Congress, Obama demonstrated he can give a speech. Big deal. We already knew that. Theatrics aside, why does it matter that the president is optimistic? He shows no sign of understanding economics. He's the one, after all, who proposes to borrow \$800 billion in the credit market so he can “inject” it into the economy where he found it. That doesn't show much understanding. So on what does he base his optimism?

Obama relies on his economic advisors, of course. But what grounds do they have for being optimistic? They all thought the so-called stimulus was a good idea, when there's no good economic theory to support it. University of Chicago economist John Cochrane says that in college economics classes government fiscal stimulus is “taught only for its fallacies.” According to New York University economist Mario Rizzo, even John Maynard Keynes gave up the idea of countercyclical deficit spending — in the late 1930s! Apparently, no one has informed *New York Times* columnist Paul Krugman and his fellow Keynesians.

So Obama's upbeat attitude counts for little. Our economic problem is not psychological. The laws of economics can't be overcome by good feelings and pep talks. There *is* more to fear than fear itself. There's government and its dim-witted attempts to fix the economy.

The first thing to understand is that the economy is contracting because of a variety of government interventions. There is no explanation in sound economic theory for an economy's going into a recession of its own accord. It takes a government to sink an economy. Only government is in a position to introduce economywide distortions that lead entrepreneurs and investors astray. It can do so by expanding the money supply, artificially lowering interest rates, and creating incentives to invest in the wrong parts of the economy relative to the preferences of consumer-savers.

Government can distort the economy in other ways also. In the present case, federal policymakers for many years contrived to channel scarce capital into housing and home finance by, among other methods, inducing a lowering of mortgage-lending standards (zero down payment, acceptance of undocumented income, disregard of bad credit histories) and by pushing its government-sponsored enterprises Fannie Mae and Freddie Mac to buy up and guarantee dubious mortgages. The result was a housing bubble that created the perception of perpetually rising prices. That in turn stimulated more shaky borrowing (prime and subprime) and more investment in fragile mortgage-backed securities.

In other words, government policy engineered a colossal economywide mistake. When that became clear, home prices began to drop, and the financial house of cards went with them. Fear and anxiety spread to other parts of the economy.

The upshot is that government activism created this mess. Therefore the solution can't be more government activism. And since the economic malinvestment is real, pep talks and optimism can't be the keys to recovery. It's not just a matter of working harder or feeling good about the future. It's a matter of saving — deferring consumption — so capital is available for investment consistent with consumer preferences. And it's a matter of government's backing off so that a secure environment exists for investors and entrepreneurs. Nothing chills the investment process more than a government whose actions are unpredictable day to day. Will the banks be nationalized? Will insurance firms be bailed out? Will government buy up bad mortgages? Maybe. Maybe not. Who can make long-term plans under these circumstances?

If the Obama administration is serious about seeing the economy recover and instilling optimism about the future, let it put into practice the only policy that can accomplish those two important things: laissez faire.

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