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The Socialist Bailout of Wall Street, Part 2

by Jacob G. Hornberger

During the recent presidential race, Republican John McCain accused Democrat Barack Obama of being a socialist, owing to Obama's belief in using the federal government to "spread the wealth." Obama, for his part, expressed surprise at being accused of being a socialist. Apparently, he's always believed that he's a strong supporter of America's "free-enterprise" system.

The irony is that McCain called Obama a socialist during the very time that McCain was supporting the federal bailout of U.S. financial firms, banks, and insurance companies. What better example of socialistic redistribution of wealth than that? Equally ironic was the fact that the bailout plan entailed the federal government's taking partial ownership of banks and insurance companies.

While pure socialism entails complete government ownership of the means of production, there are important markers of socialist activity. They include: (1) the government takes money from one group of people and gives it to another group; (2) the government centrally plans economic activity; and (3) the government owns and operates business enterprises.

Don't those three tenets describe perfectly some of the primary functions of the U.S. government ever since the New Deal in the 1930s? Isn't the welfare state a good example of government's taking money from some in order to give it to others?

An example of central planning is the Federal Reserve System, which plans the monetary affairs of the United States.

Examples of public ownership of business enterprises include Amtrak and the Tennessee Valley Authority.

Socialism is not the only economic philosophy that has guided the United States for the last 80 years. There is also an economic philosophy known as interventionism. Under interventionism the government intervenes in private economic activity with rules, regulations, subsidies, or tax benefits. That's what the SEC is all about, along with the Federal Reserve, the departments of Agriculture, Labor, and Commerce, and multitudes of regulatory agencies.

Interventionism leaves the means of production in private hands but controls, manipulates, and regulates economic activity.

It would be difficult to find a better example of both socialist central planning and interventionism than the U.S. housing market, that sector of the economy that ignited the financial firestorm that has engulfed the world.

Here is what federal central planners and interventionists did. Primarily through the U.S. Department of Housing and Urban Development (HUD), they came up with a plan that would ensure home ownership for almost every American. Home ownership is the American dream, or so they said. The problem with a free market, the planners thought, is that banks and financial institutions are ordinarily resistant to lending money to high-risk customers. The inability of many poor and middle-class people to borrow money to purchase a home is a flaw in the free market, the planners felt, so they came up with a plan that would solve the problem.

In 1977, Congress enacted the Community Reinvestment Act, which prohibited banks from discriminating against poorer-risk customers, including those who lived in poorer parts of town. However, the banks didn't actually have to assume the risk of the loans. That's where Fannie Mae and Freddie Mac came into the picture. They are quasi-government agencies that would purchase the mortgage loans from the banks, thereby relieving the banks of the risk of default.

Fannie Mae and Freddie Mac would then package the mortgages into collateral for debt instruments issued by them. The reason that investors all over the world purchased those debt instruments as investments is that the U.S. government was serving as an implicit guarantor of mortgage-backed securities. The idea was that if borrowers defaulted in payments on their loans, investors wouldn't lose their money because the federal government would cover the losses.

Ultimately, the entire house of cards came crashing down, as socialist central plans are apt to do. Large numbers of people began defaulting on their home-mortgage payments and investors were facing massive losses on their investments. As expected, the federal government entered the picture and began covering the enormous losses that institutions were suffering as a result of the home-loan scheme.

Free enterprise or interventionism?

Does any of that sound like "free enterprise"? Free enterprise means enterprise that is free of government intervention and manipulation. Here you have massive government intervention in the form of mandatory rules requiring the funding of high-risk loans, government purchase of those loans, government selling of those loans, and government guarantee of those loans, all pursuant to a socialist central plan to help people buy homes.

Yet throughout the crisis there have been those, including McCain and Obama, who have steadfastly maintained that the problem was "free enterprise" itself and, therefore, that the only solution was the heavy hand of government to "save free enterprise."

Obviously, history was repeating itself. Isn't that exactly what Franklin Roosevelt and the New Dealers said? Didn't they claim that the Great Depression reflected the failure of free enterprise when in fact it reflected the failure of monetary central planning and interventionism, as Ludwig von Mises, Friedrich Hayek, Milton Friedman, and other economists have shown?

Why were both McCain and Obama and so many others claiming that "free enterprise" was the culprit in the current economic crisis?

One possibility is that they truly believe that the United States has a free-enterprise system. If a person honestly believes that, then it's entirely logical for him to conclude that "free enterprise" has produced the current financial crisis.

And why would anyone honestly believe that America is a "free-enterprise" country, when it's obvious that Americans rejected and abandoned the principles of economic liberty during the 1930s in favor of socialism and interventionism? Because many of these people have absolutely no idea that that is what happened. From the first grade on up, government-approved schoolteachers have ingrained into students' minds that America has always had the same type of economic system — a "free-enterprise system," which failed and produced the Great Depression, and which was saved by the New Deal's welfare state and centrally planned and regulated economy.

But there's another possible explanation for why some people — extremely intelligent people who should know better — are blaming the financial crisis on "free enterprise." They know that the crisis goes to the very heart of the socialist-interventionist paradigm under which America has operated since the 1930s. Equally important, they know that libertarians know the truth and are speaking the truth about this entire charade. The last thing they want is for ordinary Americans to begin questioning the myths and lies with which America has been living for almost a century. That could bring down the entire socialist and interventionist paradigm under which America has been operating and bring about the restoration of economic liberty to our land.

Conservatives and libertarians

In blaming the financial crisis on "free enterprise," socialists and interventionists often level their criticisms at both conservatives and libertarians. In doing so, they oftentimes pretend that libertarianism is nothing more than a subset of conservatism. Since conservatives and libertarians both favor free markets and detest socialism and regulation, the argument goes, what has failed is the free-market policies of conservatives and libertarians.

The criticism is valid insofar as conservatives are concerned but not libertarians. Long ago, most conservatives abandoned opposition to the welfare state and the regulated economy and have devoted their efforts to gaining control over it and running it. Most libertarians, on the other hand, have maintained a steadfast opposition to all socialist and interventionist programs and continue to call for their repeal.

For example, do conservatives call for the eradication, rather than the reform, of such things as the income tax; the Federal Reserve System; paper money; the SEC; the departments of Labor, Agriculture, Commerce, Education, and HUD; Social Security, Medicare, and Medicaid; education grants; welfare; regulation; and trade restrictions?

No, they don't. The most they do is call for "reform" and getting rid of "waste, fraud, and abuse." But libertarians do oppose all these programs and call for their eradication, not their reform.

Thus, when socialists and interventionists claim that "free enterprise" has brought the financial crisis, they're obviously referring to how conservatives view "free enterprise" — that is, as a warmed-over, reformed welfare state and regulated economy. They are not referring to libertarianism, a philosophy in which there would be no welfare-state or regulatory laws, rules, regulations, departments, or agencies.

Would businesses fail in the unhampered market economy that libertarians seek? Would people's investments go down from time to time? Would banks go under? Some undoubtedly would. But at the same time, the risk of failure nurtures important values, such as responsibility and prudence.

Like it or not, life is insecure. The socialist illusion is that by surrendering economic liberty, the government can make life secure. It does not and cannot. As the Founding Fathers pointed out, those who trade liberty for security gain neither — and deserve neither.

In his book *The Crisis of Interventionism*, Ludwig von Mises pointed out that government interventions into economic activity will inevitably lead to more interventions. The reason is that the initial intervention inevitably produces chaos and crises which cause people to call for new interventions to solve the problems of the previous interventions. At the end of the interventionist road is the totally controlled economy — omnipotent government.

In the current crisis, that's what the socialist bailout of financial firms, partial nationalization of banks and insurance companies, a moratorium on foreclosures, proposals for the government to purchase mortgages, and increases in deposit insurance are all about. They are all socialist and interventionist measures that purport to solve the chaos and crises arising from previous interventions. They lead in but one direction: bankruptcy, inflation, chaos, crises, omnipotent government, tyranny, and the loss of liberty.

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