

## Charles Wheelan, Ph.D. The Naked Economist



### The Twilight of Free-Market Ideology

*by Charles Wheelan, Ph.D.*

Posted on Friday, October 24, 2008, 12:00AM

When I heard Alan Greenspan's testimony before Congress last Thursday, I had one immediate thought: This is the beginning of the end for the free-market ideologues.

According to press reports of the testimony, Greenspan told Congress that he "had put too much faith in the self-correcting power of free markets." That's no small statement.

In fact, it struck me that if 1989 was the year when no reasonable person could still believe in communism (or any of its government-intensive relatives), then 2008 will go down in history as the year in which the free-market zealots saw their "wall" come crumbling down.

#### Too Free to Last

You don't have to take it from me. Just look around. One by one, the economic meltdown is slaying one shibboleth of the uber-free-market camp after another.

Here are some of the inflexible, hardcore beliefs that are crashing along with the stock market:

- **Individuals always know best**

Not so much, it turns out. The whole financial crisis is rooted in irrational personal decisions. Consumers borrowed more than they could afford based on the naive assumption that housing prices would always go up. Not just a few people -- lots and lots of them.

- **Firms always manage resources better than government**

Let's take a poll of Lehman Brothers shareholders to see how they feel about that statement. One of the most remarkable things about the whole crisis is the amount of wealth destroyed by private firms. The shareholders and managers of firms like Bear Stearns, Lehman, AIG, Countrywide, and others destroyed themselves.

That can't be blamed on flawed regulation. No matter how bad the regulatory scheme, it's never rational for private firms to destroy themselves along with all of the wealth of their shareholders.

It's definitely true that government incompetence deserves a share of the blame (e.g., Fannie and Freddie, or the push to put low-income citizens in homes they couldn't afford), but that doesn't make blindly eliminating regulations the answer. Deregulation and sensible regulation are not synonymous.

- **Tax cuts are an economic miracle balm**

I suppose one could argue that the economy would be in even worse shape right now

ADVERTISEMENT

without the Bush tax cuts -- but that's pretty thin gruel. The more reasonable argument is that the deficits that have accumulated over the last eight years -- during relatively good economic times -- are a hugely destabilizing force going forward. Everything happening right now is made much worse by the fact that the United States is highly indebted to the rest of the world. The ideologues pushed tax cuts without demanding corresponding spending cuts, and that's just plain irresponsible.

Three entities borrowed recklessly over the past decade: homeowners, Wall Street, and the U.S. government. So far, only two of them have had their reckoning.

#### • Less government is always better

I don't think most Americans are prepared to tell Hank Paulson and Ben Bernanke to leave the markets alone right now. Nor are they pushing for the FDIC to scrap the insurance on bank deposits. And many of us are wondering: 1) What is a credit default swap? 2) How could something I've never heard of be destabilizing the economy? and 3) Why didn't someone do something about this?

Does all of this mean that economics books should be burned and Nobel Prizes returned to Stockholm? Absolutely not. The free-market zealots were never right in the first place; they twisted, bastardized, and oversimplified conventional economic thinking. They saw simplicity where the bulk of economists saw tradeoffs and qualifications. They clung to simple and elegant views despite all evidence to the contrary -- and the analysis in the first 10 chapters of any basic microeconomics text.

A colleague of mine, who worked in (and was frustrated by) the George W. Bush administration, coined a term that summarizes it best: faith-based economics. That's not supposed to be how it works.

#### • Mainstream economists have a profound belief in markets

But they also understand that markets fail in some cases. And they recognize that most markets work better with some government infrastructure, whether it's information, modest regulation, or just a place to sue someone who cheats you.

Mainstream economists recognize the costs of taxation; taxes take money out of people's pockets and distort behavior in ways that can have serious economic costs. But the non-ideologues also recognize that tax revenues can be used to provide government services that make people better off. Good policy is about managing that messy tradeoff.

Mainstream economists recognize that individuals have a pretty good idea of what they want -- but that those same individuals sometimes make systematic errors of judgment, which can lead to things like bubbles and panics.

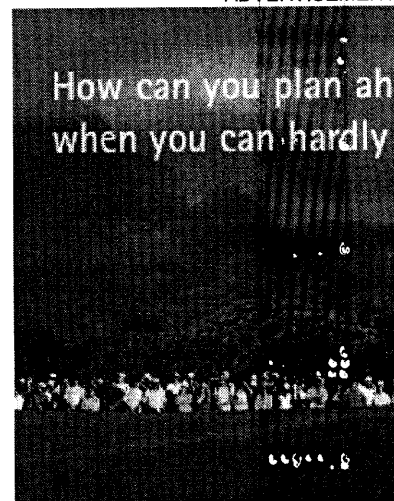
Mainstream economists recognize that too much regulation can harm innovation and diminish prosperity. But they also recognize that sensible regulation provides information and security, both of which make it much easier to do business with strangers. Regulation also protects third parties from market behavior that has negative spillovers, whether it's the guy who drinks too much at the bar before getting into his car or the paint factory that cuts costs by dumping lead in your drinking water.

#### A Monument to Self-Interest

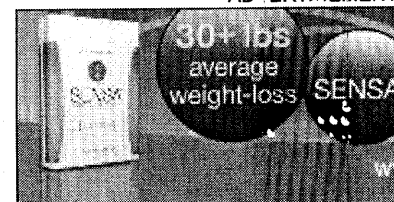
There's now a museum in Berlin where visitors can go to see a remnant of the Berlin Wall and learn about the damage done by an overly rigid, poorly conceived ideology.

Maybe there should be some kind of 2008 Meltdown Museum. It would have a large subdivision of homes, all with "for sale" signs out in front. And there would be a quotation from Alan Greenspan inscribed over the arch at the entrance:

"Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief."



ADVERTISEMENT



#### SPONSORED LINKS

I Got Fired  
Now I make more than my old boss  
Online is so Easy.  
NickGetsGreen.com

What's Your Credit Score?  
724 Is an Excellent Score- Get Your  
Score For \$0 Today.  
TriFreeCreditReports.com/free

student advice personal finance  
Learn the Basics of College Stud  
Online. Visit us Today.  
www.StudentFinanceDomain.com

Retired At 33 - Personal Finance  
How I Actually Did It. No Gimmick  
Investment Required.  
www.RetiredAt33.com

Finance  
Discover free information about f  
discovertheinformation.com/finar

Free Book: Managing Your Finar  
Get free book with proven financi  
biblical principles.  
www.gnmagazine.org/finances

#### 1606 COMMENTS

Showing comments 1-5 of 1606 Next >>

Sort: first to last

**Angus F** - Wednesday, March 18, 2009, 6:40AM ET Report Abuse

Overall:

So many conservative ideologues, with so little clue. Blaming the govt for this mess is absurd, as is trying to blame Fannie and Freddie. Nearly all loans that failed were originated by the private sector, not F&F. The areas where defaults are at the peak are condos in Vegas and California. As for Austrians. Well they're pretty much useless. A bankrupt ideology looking for a fact.

**future\_yupi** - Monday, March 2, 2009, 12:38PM ET Report Abuse

Overall:

I might move to Chicago just to vote against this douchebag.

**westhampnett** - Wednesday, February 11, 2009, 10:26AM ET Report Abuse

Overall:

Yes individuals and companies make bad decisions and fail; but the market system corrects and the economy survives and thrives. In the wonderful new socialist world we are entering (see Newsweek's cover), decisions about economic success and failure are made by politicians; corruption and failure of the economy is guaranteed. If you think individuals make irrational decisions, wait till you see the decisions of individual politicians.

**Yahoo! Finance User** - Friday, February 6, 2009, 7:05PM ET Report Abuse

Overall:

I just one point Thunder Pants. Isn't this what happens when the government fixes prices? Government fixed the price of money/credit which gave false signals to businesses and individuals. The artificially low cost of financing resulted in massive malinvestment. The bust is the price we all get to pay. The US mercantilist society lets some pay a little bit more.

**Yahoo! Finance User** - Friday, January 9, 2009, 1:52AM ET Report Abuse

Overall:

Anyone educated in the Austrian School of Economics saw all this coming. And they are about as free market as you can get. Government actions will only make the economic ride a lot wilder - up and down. Fasten your seat belts.

Showing comments 1-5 of 1606 Next >>

The columns, articles, message board posts and any other features provided on Yahoo! Finance are provided for personal finance and investment information and are not to be construed as investment advice. Under no circumstances does the information in this content represent a recommendation to buy, sell or hold any security. The views and opinions expressed in an article or column are the author's own and not necessarily those of Yahoo! and there is no implied endorsement by Yahoo! of any advice or trading strategy.

Copyright © 2009 Yahoo! Inc. All rights reserved. | Copyright/IPP Policy | Terms of Service | Help | Send Feedback  
NOTICE: We collect personal information on this site. To learn more about how we use your information, see our Privacy Policy

Historical chart data and daily updates provided by Commodity Systems, Inc. (CSI). International historical chart data and daily updates provided by Morningstar, Inc. Fundan IQ. Quotes and other information supplied by independent providers identified on the Yahoo! Finance partner page. Quotes are updated automatically, but will be turned off a delayed at least 15 minutes. Real-Time continuous streaming quotes are available through our premium service. You may turn streaming quotes on or off. All information provided only, not intended for trading purposes or advice. Neither Yahoo! nor any of independent providers is liable for any informational errors, incompleteness, or delays, or for any contained herein. By accessing the Yahoo! site, you agree not to redistribute the information found therein.

Yahoo! Answers is provided for informational purposes only, and no Q&A is intended for trading or investing purposes. Yahoo! shall not be responsible or liable for the accuracy