

# The Undercurrent

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## Has the free market failed?

The American economy is in a state of malaise. Stock and real estate prices have plummeted, people have lost trillions of dollars, major companies have gone bankrupt, and unemployment numbers continue to surge. Undoubtedly, many students are lying awake at night wondering whether they will find work after graduation.

Meanwhile, pundits and politicians blame the unrestrained greed and “irrational exuberance” of the free-market. They call for more regulations and more controls in the name of economic stability. In other words, they want to borrow, tax, and spend the nation out of the crisis with stimulus packages and bailouts.

Why this approach? At root is the “Big Brother knows best” mentality that is fast replacing the long-standing American respect for personal responsibility and individualism. The transition has been slow, but America has transformed from a fairly free market into a highly controlled and regulated welfare state. This flyer points to the fact that what we are witnessing today is not the failure of capitalism, but of the mixed economy and government paternalism.

### Understanding Government Market Distortions

### Why These Policies Are Paternalistic

#### **1. *The Federal Reserve creates artificial demand.***

Beginning in late 2001, the Federal Reserve under Alan Greenspan drastically lowers interest rates, sending a flood of money into the housing sector that artificially stimulates demand and causes an inflationary bubble.

#### **2. *The government mandates risky credit practices.***

Encouraged by FDIC guarantees on bank deposits and coerced by legislation like the Community Reinvestment Act, banks make billions of dollars worth of subprime mortgages to individuals with low credit ratings and low incomes, i.e. subprime mortgages.

#### **3. *The government rewards reckless lending.***

Fannie Mae and Freddie Mac, both government-backed companies, further encourage reckless lending and borrowing by purchasing and guaranteeing mortgages from banks and reselling them throughout the financial system in the form of mortgage backed securities (MBSs).

#### **1. *“Big Brother knows best the cost of credit.”***

Rather than leaving individuals and banks free to determine the interest rate at which they are willing to borrow and lend money, the government imposes the rate that it thinks would be best.

#### **2. *“Big Brother knows best to whom banks should lend.”***

Rather than leaving individuals free to determine what they can afford and banks free to decide whether to lend, the government decides that it’s desirable for everyone to own homes and so implements policies to force this outcome.

#### **3. *“Big Brother knows best your financial goals.”***

Rather than leaving individuals free to make independent investment decisions the government distorts the risk of mortgage backed securities through guarantees. When individuals make bad investments, these guarantees leave taxpayers to foot the bill.

This is a small sampling of the impractical policies that have been fueled by our government’s paternalistic goals. We are now witnessing the inevitable collapse of this house of cards, precipitating the crisis in which we are embroiled today.

# Why is the current solution doomed to fail?

Rather than accepting responsibility for the failure of the regulatory state, the government has placed the blame on “greedy” businessmen. The Federal Reserve and Treasury have forced Bear Stearns into a merger, semi-nationalized AIG, and cajoled or coerced the country’s largest banks and auto companies into accepting bailout money—policies that reward bad companies for making poor financial decisions and encourage them to continue making risky decisions in the future.



*Uncle Sam, the new guy on Wall Street?*

In order to pay for all these bailouts, the government must borrow money. How much money? If you tried to count the number, it would take you more than 180,000 years to reach current estimates for the 2009 deficit. To pay back that debt, the government will either have to raise taxes (take your money) or print currency (make your money worth less). In either case, *you* will be the one paying the bill.

So long as people accept that Big Brother knows best—i.e., that individuals are incapable of managing their own lives—we should expect more extreme versions of the same policies that got us into this mess as the government more vigorously intervenes to “fix” the economy. In essence, paternalism has led our government to attempt the economic equivalent of curing cancer with cancer.

# What is the proper solution to the problem?

The solution is for America to embrace its founding principles—individualism and freedom. If we are to emerge from economic ruin, we must reject the notion that Big Brother knows best and begin rolling back all the regulations, laws, and agencies that try to direct voluntary choices in the marketplace. We must leave people free to act. In practice, this includes:

- Ending the bailouts of financial institutions and other companies;
- Letting bad companies suffer the consequences of their actions, which may mean bankruptcy or failure;
- Repealing the regulatory regimes of the SEC, FDIC, the Federal Reserve, and other institutions;
- Repealing destructive legislation like the Community Reinvestment Act and Sarbanes-Oxley; and,
- Returning to a system of sound money—i.e., a gold standard—where the government no longer controls the money supply.

In other words, a return to the American principle of individualism and a rejection of government paternalism is mandatory if we are to overcome this crisis and prevent future ones. There is only one system that is consistent with this conception of the role of government and that can restore America to financial health. It is a system that has never been fully realized and one that has never been as needed as it is now. Ayn Rand called it “the unknown ideal,” and it is our failure to know it that has led us into the dire straits in which we find ourselves today. If we wish to escape from this financial malaise, we had better acquaint ourselves with **laissez-faire capitalism** soon.

What can *you* do? Educate yourself. Think, read, and become well informed. Understand the arguments for and against capitalism, and judge those arguments in light of what you see around you. If you are interested in doing so, there is no better way than to pick up a copy of Ayn Rand’s novel *Atlas Shrugged* or her treatise *Capitalism the Unknown Ideal*.

**“No politico-economic system in history has ever proved its value so eloquently or has benefited mankind so greatly as capitalism—and none has ever been attacked so savagely, viciously and blindly. The flood of misinformation, misrepresentation, distortion, and outright falsehood about capitalism is such that the young people of today have no idea (and virtually no way of discovering any idea) of its actual nature.” -Ayn Rand**