



## *Credit Crisis and Irresponsibility*

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The global financial turmoil that started in the US middle of last year is continuing with even harsh results until this week. The coming weeks and months do not appear to be cutting or slowing the negative trend. Below are two of my short papers on the subject.

### **Capitalism without failure is like religion without sin**

24 September 2008

Capitalism without failure is like religion without sin. The statement is from a CATO scholar, Gerald P. O'Driscoll Jr., in his paper, [“Treasury’s Thieves”](#). Perhaps people should keep that in mind before they conclude that the current financial turmoil in the US, which is spreading to financial markets abroad, marks the beginning of the “end of capitalism”.

The current financial "meltdown" should happen. If the meltdown does not happen today, then it should happen tomorrow, or next week, or next year. And it should continue, if only to weed out the irresponsible corporate leaders and the cheaters.

What should not happen is a government bail-out of collapsing and imploding big banks and firms. In this case, the proposed US government bailout for the financial sector to the tune of \$700 billion -- not counting the projected budget deficit of more than \$480 billion by the end of 2008 of the federal government alone (many states, cities and counties have their own sets of budget deficits).

So why is government bailout not justifiable? Three important reasons.

One, make those responsible for a corporate collapse be accountable for their mistakes. Hence, they should pay the price for their irresponsibility and misbehavior. Those who should sink must sink. And taxpayers' money should not be used to bail out irresponsible corporate guys.

Two, governments by themselves have no money on their own to bail out failed enterprises except for what governments confiscate from the income and savings of the hardworking citizens in the form of various taxes, charges regulatory fees and fines, or by printing money endlessly through their central banks, which can push inflation upwards endlessly, and thereby rob again the responsible citizens of the real value of their income, savings and investments.

And three, the US Fed's and other central banks' (like the Europe CB) large-scale bailout pool and consequent monetary policies will be distortionary. In cases like this, producers and manufacturers are forced to watch the behavior of the Fed or any central bank on whether it will raise or lower or keep existing interest rates, or protect the currency from further depreciation or appreciation, rather than watch the behavior of consumers (if their preferences and buying pattern are changing or not) or the behavior of competing producers from other countries (if they are producing better quality goods and services or selling at lower prices or a combination of both).

High inflation is caused mainly by lower supply relative to demand. So to address high inflation, expand supply relative to the size of demand. But central bank bureaucrats think they can solve the world's price problem by centralizing monetary tools in their hands, and squeeze money supply by tightening credits and raising interest rates -- which in the process choke many entrepreneurs and producers, both big and small.

The term "socialism for the rich" (under a longer phrase, "profits are privatized but losses are socialized") is wrong. The proposed multi-billion dollar bailout can be aptly called "socialism for the irresponsible" because only irresponsible and envious people would love socialism. Under socialism, the lazy and the envious will still eat, will still have allowances, and will be entitled to free "quality" education, health care, housing, etc. because social equality is non-negotiable.

For the socialists or trying-hard socialists, personal and corporate responsibility or irresponsibility do not count much. What matters to them is more "government responsibility". So, corporate irresponsibility of officials of those big firms don't count much, those firms are "too big to fail", they should not sink, and their officials need not go to prison.

Some people ask, "Who are the irresponsible? Who defines 'irresponsibility' and who should penalize them?" There can be a BIG political battle on the definition of "irresponsible" because among the most irresponsible institutions involved in the current financial "meltdown" is the BIG US government itself.

It is easy to spot an irresponsible guy or institution: they live beyond their means,

consistently. They spend much bigger than their income or revenue, consistently. Or worse, they spend and ask for more subsidies even if they have no income, nor have any plan to work and have regular income. A person who in his late 20s or 30s still depends his parents' allowance is irresponsible. A bank that lends to many people, who it perfectly knows have no jobs or no stable jobs and income, is irresponsible. A government on budget deficit, for one, two, five decades or more, is irresponsible.

So, how should they be penalized? The penalties for cases like failed companies are already in the books of any country's legal system. Bank or corporate officials who lose their stockholders' money should go to prison, or the cemetery perhaps -- in the case of those unlucky to be caught by really mad and impoverished investors.

After the US government announced the huge bailout fund that it seeks from the US Congress, the US stock markets were battered once more, the US dollar was knocked down further, and even world oil prices were up once more.

Why? It's the distrust on the US government, distrust on any fiscal "stimulus" by a bailout scheme because of the big taxes and fees that will be confiscated from the pockets and monthly salaries of US citizens in the coming months and years.

A friend shared that the proposed Treasury bailout plan has this provision:

"Sec. 8. Review. Decisions by the Secretary pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency."

Dictators hate for their work and decision to be reviewed and questioned. "Non-reviewable" clause by any court or any agency speaks of the absence of accountability and transparency, absence of personal and official responsibility, for any mistakes in the future. If they are not dictators, then they should be fully transparent and fully accountable for their actions and policy decisions. If they do not want to be accountable for any future mistake, then they should not initiate such bailout move in the first place.

The pattern and the dangers are there: individual responsibility is meaningless under a socialist or trying-hard socialist framework. Everything is "government responsibility". The primacy of the collective over the individual, always. And in their books, to have order in the collective, each individual -- except the administrators and governors of the collective -- must surrender a big portion of their income, their savings and their personal liberty, to the collective. Then there will be order in society, harmony and equality. Perhaps equality in misery.

Again, corporate failures and bankruptcies, as well as expansion and becoming big, are part of the game under a capitalist set-up. Market failures almost always result in market solutions, unlike government failures that almost always result in more bureaucracies and offices to find out how much have been wasted and stolen already.

Here at home, if Metrobank or BDO or BPI would "collapse" someday for whatever reason, taxpayers should not support any bailout by the government, whether through the the central bank (BSP) or congressional appropriation. Let any big but misbehaving ship sink if it must -- that's fair game, and this alone will put enough pressure and discipline on existing banks, corporations and enterprises not to act irresponsibly. Government has little or no role on private contracts between stockholders or owners and corporate officials, except with its usual role of a parasite – collecting high and dozens of different taxes when one or two taxes will suffice.

\* This article was posted in

[http://www.thelobbyist.biz/column\\_detail.php?id\\_article=940&id\\_category=25](http://www.thelobbyist.biz/column_detail.php?id_article=940&id_category=25)

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## **The crisis of irresponsibility**

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In any abnormal times, the term “crisis” is among the most quoted, most mentioned – and even most abused – word or adjective to describe a particular situation. For instance, when a person is in deep mental and emotional trouble, he or she is in a “personal crisis”. Or when a corporation is in deep financial trouble, it is experiencing a “corporate crisis”. Or when an administration in power encounters deep instability, it is said to be in a “political crisis”.

A crisis is something really serious. In a “personal crisis”, the person may hurdle the problem or he/she may commit suicide. In a “medical crisis”, a patient either recovers or dies. In a “corporate crisis”, the company either survives or it goes bankrupt. In a “political crisis”, the administration either survives or it falls and the political opposition takes over. The bottom line is that once either outcome (survival or death/bankruptcy) is reached, the crisis is over. In a sense, a “crisis” is almost always short-lived; it’s never dragging, like “economic crisis” for 5 or 10 or more years.

The on-going economic turmoil in the US and the rest of the world has been termed a “credit crisis”, a “financial meltdown”, “market free fall”, and even worse, a “crisis of capitalism”. The use of the latter phrase is implying that the current economic woes could be the beginning of the “end of capitalism”, and the rise of what? Rise of socialism, or Hugo Chavez, or other forms of statism?

For lack of a more apt term to describe the on-going financial troubles in major economies around the world, this writer would rather use the term “crisis of irresponsibility”. Here are some reasons why.

**One**, borrower irresponsibility. There is general acceptance, if not consensus, that the immediate cause of the current global financial trouble was the widespread default of sub-prime borrowers in the US for the houses they bought. People who have small or no stable income were allowed to buy houses whose price are much higher than what those borrowers could really afford to pay if some explicit or implicit subsidies were absent. The immediate symptom showed up in July 2007 after Wall Street investors started pulling out their money after learning those huge sub-prime homeowners' loan default.

**Two**, lender irresponsibility. Anticipating continued "housing price bubble", the lenders – developers, commercial banks, mortgage houses, investment banks, insurance companies – lent even to sub-prime borrowers, people who have questionable capacity to pay those high-priced houses, charged them higher interest rates.

**Three**, housing policy irresponsibility. When a government policy forces banks to give out bad loans, then more bad loans will be given away. Eamonn Buttler in his article, "[Blame bad rules, not capitalism](#)", wrote "(On) 12 October 1977, US President Jimmy Carter signed the 'anti-redlining' law. Before then, lenders generally denied loans to people in poor neighborhoods. But the politicians--with good intent--wanted to make home ownership available to all Americans. So lenders were forced into giving out risky mortgages: what we now call 'sub-prime' loans."

And **four**, plain BIG government irresponsibility. Making a bad public policy even bigger and worse. For instance, after the "anti-redlining law", semi-governmental companies Freddie and Fannie made investors believe that the bad mortgages they made were guaranteed by government, creating a "moral hazards" problem wherein complacency can be rewarded with bail-out, not penalized with bankruptcy.

Now the public in the US and around the world is bombarded with "more government financial regulations please" mantra. Really? But the US government cannot even properly discipline itself, generating hundreds of billions of dollars of budget deficit every year (at least \$480 billion by end-2008, for instance). And worse, the Federal government is facing an estimated \$56 trillion debt.

In a commentary, "[America's \\$53 trillion debt problem](#)", David Walker wrote, "The nation's real tab amounted to \$53 trillion as of the end of the last fiscal year (September 30, 2007). That was the sum of our public debt; accrued civilian and military retirement benefits; unfunded, promised Social Security and Medicare benefits; and other financial obligations... The rescue package and other bailout efforts for Fannie Mae, Freddie Mac, AIG and the auto industry, escalating operating deficits, compounding interest and other factors are likely to boost the tab to \$56 trillion or more by the end of this calendar year."

The US' gross domestic output (GDP, the combined production of goods and services by the federal + local and state governments + private corporations + households) in a

year is about \$14 trillion. The cumulative debt of the federal government alone will be about 4x of GDP!

So, can an institution that can irresponsibly accumulate various debts amounting to 4x of GDP, be the "bright guys" to provide "leadership" in regulating further all corporations, earning or misbehaving, private corporations? This does not look good.

From one big government intervention (encouraging or forcing sub-prime and risky loans and fiscal irresponsibility) to another (xx billion \$ for Fannie and Freddie, \$85B for AIG, and the enacted \$700 billion bailout or "rescue package", and higher future taxes to pay past and current bailouts and borrowings), there seems to be no logical conclusion or time table for the never ending big government intervention and taxation.

US capitalism needs the current "electric shock" to deliver real hard lesson for both the American capitalists and the American government. Private enterprises should be allowed to grow big or go bankrupt -- without government intervention. The job of the government is to ensure the rule of law, that parties honor their obligations and contracts with other parties, and that robbers, killers and other criminals along the way are neutralized.

The US stockmarket and the rest of the economy have so far shed several trillion dollars of losses and failures because their debt culture (federal debt + local and state governments debt + corporations and household debt) has bloated the economy by trillions of dollars. The bubble should pop, the excesses should be removed, and irresponsibility (personal, corporate and government) should be checked and controlled.

Failing big business should not marry big government. But it is happening now, nonetheless. The Treasury Department, the Fed, the White House and Capitol Hill think that to "solve" previous and current government failures, even bigger government intervention, regulation, borrowings and taxation should be introduced

Plenty of news stories these days say that many American households are cutting back on their consumptions except the necessities -- food, health care, education, etc. Which means Americans feel they are poorer now, or they anticipate they will be poorer in the coming days. How can they be made feel "richer"?

One option is a large-scale income tax cut. Allow them to keep more of their monthly or annual income, let them spend the "de facto" wage increase. Someone's spending is somebody else's income. But all the above US government agencies can think of are retain, if not increase in the future, current high income taxes – to finance more government spending, more bail-outs, and possibly, more printing of money. The few tax cut measures in the multi-billion bail-out was more of "sweetener" so that more Republican legislators will support the huge bail-out bill.

The author of the book, “In Defense of Global Capitalism”, Mr. Johan Norberg, has some good arguments why the “more government financial regulations please” mantra is wrong. In his short paper, “[Regulators cannot avert next crisis](#)”, he wrote:

“Every crisis has led to thousands of new pages of regulation, why is it that regulation doesn't stop crises from happening again? Look no further than the US federal institutions in Washington, DC, and we find 12,113 individuals working full time to regulate the financial markets. What did they do with the powers they had?.. So we get new rules that target the mistakes that everybody already knows they must avoid. The next possible crisis and its causes are so far unknown, and our regulations may have no effect or even make them worse...”

To sum up, is the current “crisis of irresponsibility” leading to continuation or death of irresponsibility?

Based on the above discussions and on-going global development, the answer seems to be the former, a continuation, if not expansion, of irresponsibility. But as mentioned earlier, a crisis is short-lived and not dragging for a long time. There is a \$56 trillion debt somewhere, and that’s for the US federal government debt alone. Not included there are several trillion dollars debt by US local and state governments, plus trillion dollars more by other central governments of other rich countries (Europe and Japan).

So there should be more crisis ahead in the coming years. But one really big crisis out there will definitely be resolved in favor of death of irresponsibility, especially of big government irresponsibility that encourages, directly or indirectly, personal and corporate irresponsibility. When people around the world will assume more personal and parental responsibilities in running their own lives, their own households and communities, and expect less “government responsibility”, then societies will be headed to a new world order and ultimately, world peace.