We need more failure

Coddling bad decision-makers undermines our economy

By Eric Grover

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Much has been made of President Obama's stoking class warfare and demonizing success. Less attention, however, has been paid to the consequences of the president - and his predecessor - taking the sting out of failure.

Free-market capitalism is a self-correcting system of profit and loss. There is enormous dynamism and intelligence in billions of individual decisions to buy, save, invest, produce, hire and allocate resources to where they are most highly valued. It can't be matched by the shrewdest politicians and regulators.

Profits signal the market to steer resources to those making best use of them. Failures, however, cause capital, labor and entrepreneurial zeal to be allocated away from activities delivering less value. Failure is a vital part of the system.

Nowhere has protecting people from mistakes caused more damage than in financial services and housing. Under Washington's direction, government-sponsored-enterprises Fannie Mae and Freddie Mac guaranteed and purchased risky mortgages, insulating originators from losses. Thus protected, banks underpriced and overextended housing credit.

Preposterously, during a 2003 House Financial Services hearing, Rep. Barney Frank, Massachusetts Democrat, belligerently maintained the fiction Fannie and Freddie weren't backed by the government: "There is no guarantee, there is no explicit guarantee, there is no implicit guarantee, there is no wink-and-nod guarantee." Would it were so. In September 2008, the U.S. Treasury assumed control of the failed mortgage Goliaths. So far, taxpayers have chipped in $141 billion. The tab is still mounting.

When financial giants began teetering, the Federal Reserve bailed them out. To justify the Troubled Asset Relief Program, President George W. Bush and Treasury Secretary Henry Paulson contended letting big banks fail would cause a contagion, bringing down the financial system. Maybe. We don’t know what would have happened if Bear Stearns had been permitted to fail and $313 billion hadn’t been injected into 708 financial institutions.

The Dodd-Frank Act institutionalized a regime where behemoth banks are too big to fail and attempted to substitute a regulatory straight-jacket for management judgment and market discipline. The market, however, is a more ruthless and efficient regulator than the smartest Washington mandarins.

Smothering regulation and government guarantees against failure have huge hidden costs: unrealized innovation and survival of bad financial institutions, management and practices.

Notwithstanding higher capital requirements that Dodd-Frank imposes, too-big-to-fail behemoth banks have been given an advantage. Now they can more easily cope with the regulatory burden and enjoy cheaper capital costs than community banks.

From the late 1990s to 2006, easy Fed credit and the government’s systemic weakening of mortgage credit standards propelled real housing prices up an unprecedented 90 percent. Now Washington seeks to stem foreclosures and plummeting house prices.

President Obama’s revamped Home Affordable Refinance Program makes it easier for underwater borrowers with Fannie- and Freddie-backed mortgages to refinance. It rewards the overleveraged, subsidizes interest and principal payments, punishes lenders and investors, and keeps underwater mortgagees in their houses to curry favor with voters in 2012.

While politically popular, more easy credit is like prescribing scotch for a hangover.

Overleveraged and underwater homeowners should downsize or rent. Foreclosures and falling prices are the solution, not the problem. The housing bubble needs to deflate. Only then can a sustainable recovery begin.

In its last breath the Bush administration rescued failed Chrysler and General Motors, yet neither posed a systemic risk. In bankruptcy, crushing union contracts and pension obligations would have been curtailed and viable assets unshackled.

Extending unemployment benefits to a mind-boggling 99 weeks destroyed human capital and suppressed job creation. With his eye on re-election, Mr. Obama wants to continue two-year unemployment benefits. White House spokesman Jay Carney ludicrously argues it's a job creator. To the contrary, it's a job-destruction measure.

Before shilling for him in the administration, the president's own Council of Economic Advisers Chairman Alan Krueger rightly wrote "job search is inversely related to the generosity of unemployment benefits," and "the job finding rate jumps up around the time benefits are exhausted." Who knew?

Even Obama cheerleader Paul Krugman in 2009 wrote, "Public policy designed to help workers who lose their jobs can lead to structural unemployment" and "reduces a worker's incentive to quickly find a new job."

Yet the administration argues that unemployed workers spending benefit dollars stimulates the economy. But every unemployment-benefit dollar must be taken in the form of taxes; borrowed or printed money from those producing to those who aren't. That's money that would otherwise have been productively invested or spent by businesses and individuals in the private sector.

Paying people not to work for two years isn't compassion - it's cruel. They lose work habits and self-respect, and become less attractive to employers.

Steven Chu's Department of Energy provided billions in loans to dozens of alternative fuel ventures with questionable economics. A rash of them, including Solyndra and Beacon Power, went belly-up. Only weeks after Solyndra's high-profile bankruptcy, the department provided $737 million in loan guarantees to politically-connected SolarReserve and $337 million to Mesquite Solar. If they're commercially viable, they don't need government guarantees.

The state shielding individuals and businesses from failure causes risky investment, destroys jobs and makes America poorer.

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