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## Today's Crisis Is Rooted In 1930s Policies

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A year after the financial bubble burst, recovery still struggles against the political meddling that caused the recession in the first place.

But the G-20 meeting of government leaders in Pittsburgh offers more of the contradictory promises made in April, offering bailouts and subsidies while condemning protectionism.

We would all be better off if the Western economic powers had simply let the recession work itself out.

The financial crisis was not caused by bankers. Bankers have been doing their business for centuries.

They did not simply get together and agree that suddenly they would take huge risks and get really greedy and really careless with other people's money. They made spectacular mistakes, but we must look for the source of those mistakes.

Nor was the crisis caused by world financial imbalances.

Yes, America was a massive buyer and China was a massive seller. With those dollars, the Chinese government has bought lots of American securities and other investments. But it's not asking for its money back. That imbalance did not suddenly explode into a financial crisis.

No, the root of the crisis was back in the Great Depression of the 1930s when U.S. authorities made loans more widely available to stimulate housing. In the 1970s, President Carter intervened to help poor minorities onto the housing ladder.

President Clinton strengthened this, and the banks feared regulatory reprisals if they did not make more loans to people who were poor credit risks, even those unemployed and living off welfare.

The banks knew this was very risky. While the economy was growing, even the poorest could afford to pay off home loans. But if growth faltered, and unemployment rose, many marginal borrowers would be unable to pay.

So the lenders repackaged and resold these loans. Many buyers had no idea how risky the underlying loans really were, not least because many appeared to be government-guaranteed. So America's disease spread around the world.

But the symptoms of the disease never showed because the federal authorities, and Britain's too, always flooded the world with credit whenever downturn threatened. They did it in 1987, when stock markets crashed on fears about banks.

They did it again spectacularly after 9/11. They slashed interest rates. so more people who could not afford it took home loans. Rising house prices in Britain and America encouraged the cycle.

When at last debtors started defaulting, the whole system crashed. So politicians pumped in more of the easy credit that caused the crash in the first place.

Instead, they should have let banks with bad business fail, to expose and sterilize the bad loans. The banks could then have carried on with their sound lines of business, or sold them to healthier institutions, instead of becoming zombie banks — half alive with good business and half dead with bad. The financial system would have picked itself up and been stronger for it.

The bank bailouts and subsidies have created too many zombies, kept alive only by taxpayers' money, not by real market forces. The British government now owns a majority stake in Britain's biggest banks.

With one breath, politicians are telling the banks to lend more money to refloat the economy and, with the next, they are telling them to be more prudent and rebuild their balance sheets.

Because of the huge scale of their financial sectors, America and Britain are the countries most affected by the crisis. They have plugged the immediate financial black hole, but they have borrowed far into the future; it will take Britain 30 years to pay off its new debts.

The cost is borne by the whole world. With all these debts, Britain and the USA are going to be poorer in the future.

That means fewer cars from Japan and Germany, fewer vacations in Spain and Thailand and fewer services from India and Eastern Europe.

This fall in trade is exacerbated by frightened politicians everywhere turning to the addictive drugs of protectionism and subsidy (including 17 out of the G-20) when we need the boost of free trade. Manipulating markets means opposing the will of millions upon millions of people cooperating by working and trading together freely.

The Group of 20 top economies meeting in Pittsburgh over the weekend already plans irrelevant populist intervention on bankers' bonuses, tax havens and even climate change.

World leaders should stick to their own promises of free trade and sensible regulation and then get out of the way.

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