

Government Bailouts: *Financing Failure*

By Vern McKinley



If there is one lesson casual observers took away from the global financial crisis and the accompanying bailouts of the 2000s, it is that the American government does not believe that a big financial

institution can be allowed to fail. According to many of the nation's key policymakers, including and most notably Timothy Geithner and Ben Bernanke, the interconnections and potentially hazardous economic consequences are simply too great to risk shutting down such a behemoth. In October, for example, rumors swirled that Dexia Bank of Belgium, which was bailed out three years earlier, is now a prime candidate for another bailout to avoid such a doomsday scenario. To take the Geithner and Bernanke theory one step further, the idea of shutting

down a multitude of large banks in response to a single crisis would be unthinkable. According to the *Chicken Little* crowd, the sky would collapse if policymakers made that choice, as credit lines would freeze up and the financial system in question would be plunged into a Depression-like frenzy that would take decades to recover from.

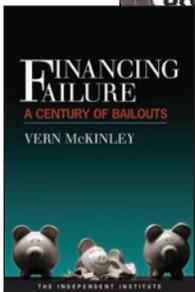
A little trivia game is in order to test how this narrative actually compares with the history of banking

reality. What do the following companies have in common: MCorp, Republic Bank Corporation, BancTexas, First City Bancorporation, Texas American

Bancshares, Interfirst, National Bancshares Corporation, Texas Commerce Bancshares, and Allied Bankshares? The answer is that these were 9 of the top 10 banks in the Texas economy during the early 1980s. Texas, as one of the largest states in the country, by no means operates a small economy. If it were an independent nation, Texas would be the 13th largest economy in the world. From the late 1980s to the 1990s, a mere decade after the height of the glory days for these institutions, all nine were wiped off the banking map. The first seven on the list failed outright, and the last two were approaching failure when taken over by out-of-state bidders. In fact, two of the banks, BancTexas and First City, approached failure twice: the first time, the FDIC bailed them out (in 1987 and 1988). Even with those bailouts, both banks ultimately failed just a few short years later.¹

The Texas economy was highly regulated in the 1980s, with strict limits on out-of-state ownership leading to a closed banking system. Unlike the heavily interventionist response to the 2000s' crisis supported by Geithner and Bernanke, the

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Vern McKinley is Research Fellow at the Independent Institute and author of the forthcoming Institute book, *Financing Failure: A Century of Bailouts*.

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President's Letter

A Gala for Liberty at 25!

We are truly privileged to have hosted our recent 25th Anniversary celebration, **A Gala for Liberty**. The event allowed us to present the Alexis de Tocqueville Award to three champions in the fight for freedom: **Lech Wałęsa** (Nobel Peace Prize Laureate), **Mario Vargas Llosa** (Nobel Laureate in Literature), and economic historian **Robert Higgs** (Senior Fellow, The Independent Institute). It was also a time to thank those who have been supportive over the years:



- “The Independent Institute is excellent.”
—**Gary Becker**, Nobel Prize Laureate in Economic Sciences
- “The Independent Institute has a well-deserved reputation for rigorous analysis. . . . I am happy to commend you for the clarity of your insights, not least those into the nature and blessings of economic freedom.”
—**Ronald Reagan**, 40th President of the U.S.
- “In uncovering the truth, the Institute does not accept the pronouncements of government officials at face value, nor the conventional wisdom over serious public problems.”
—**John MacArthur**, Publisher, *Harper's*
- “I believe there are very few ways that you can help humanity so greatly as to spread the benefits of the concept of free competition, and one of the great organizations worldwide that is now spreading that concept is The Independent Institute.”—**Sir John Templeton**, Founder, Templeton Global Funds

To propel the ideas of liberty to new heights, for our 25th Anniversary we have launched **Prime Time for Liberty**. Ensuring that our award-winning results redefine and redirect debate even more, we've turned up our efforts, with attention-grabbing publications, media, and social networking initiatives. For example, our Facebook network has doubled to 60,000 in just six weeks.

We hope you will join us by becoming an **Independent Associate Member**. With your tax-deductible membership, you can receive a **FREE** copy of *Financing Failure* (p. 1), *No War for Oil* (p. 5), or *The Independent Review* (p. 3), and other benefits (see attached envelope).

David J. Theroux

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The Independent Review

Big Government's Premise • Can Government Be Shrunk?

What hidden premise underlies the argument for a big, intrusive government? Can the growth of government be reversed? These questions are addressed in two articles that appear in the Fall issue of *The Independent Review*.

Against Overlordship

In his commencement address to the University of Michigan in 2010, President Barack Obama said, “We, the people, hold in our hands the power to choose our leaders and change our laws, and shape our own destiny.” The phrases were chosen to resonate with Americans across the political spectrum, but their precise meaning and implications are the subjects of controversy. Which activities may the state legitimately undertake in the name of “the people”? Is it morally acceptable, for example, for the state to require the people to purchase health insurance?

These questions, economist **Daniel B. Klein** suggests, boil down to whether or not the claims of the state trump an individual’s right to justly acquired property—an issue that separates progressives and social democrats from conservatives and libertarians.

“For social democrats, the state is the overlord and the polity is its dominion,” Klein writes in “Against Overlordship.” In other words, many “progressives” and left-liberals view the relationship between the citizenry and the state as similar to the relationship between the guest and the innkeeper: one is consenting to the other’s rules simply by staying on the grounds.

Today’s progressives seldom discuss that core belief—the hidden premise of their political agenda—but their intellectual forerunners did, in the decades surrounding the turn of the twentieth century. Their challenge to classical liberalism was not adequately met, and the result was an intellectual sea change that cleared the way for the expansion of intrusive government.

“Against Overlordship” is available at www.independent.org/publications/tir/article.asp?a=848.

Shrinking Leviathan

The U.S. government is involved in the American economy on a scale that few would have predicted a century ago. In 1900, Uncle Sam spent about 3 percent of national income, and state and local governments spent about 6 percent. Today, federal spending amounts to about 30 percent of national income—roughly double what state and local governments spend combined.

Cutting back the size and scope of the federal government may seem futile to those who understand how special interests have won government favors at great cost to taxpayers. Must advocates of limited government resign themselves to the Leviathan state?

The answer, according to **J. R. Clark** and **Dwight R. Lee**, is a resounding *No*. The task of reversing the growth of government is formidable, but it is in principle doable. In fact, some of the forces that produced Big Government could also act to shrink it, the two economists explain in “Shrinking Leviathan: Can the Interaction Between Interests and Ideology Slice Both Ways?”

As advocates of Big Government became more numerous their goal became more attainable, and this emboldened them further. But bandwagon behavior can also move in the opposite direction: if more people grow disenchanted with Big Government, the perceived value of working to reduce it will rise, making retrenchment even more likely. Shrinking Leviathan could become an ideal so popular that it overcomes resistance from special interests.

Moreover, voter behavior would reinforce such a trend. Because voters know that a single vote doesn’t decide an election, they vote largely according to their ideology, rather than according to whether they might gain or lose a perceived government perk as many pundits believe.

“Shrinking Leviathan” is available at www.independent.org/publications/tir/article.asp?a=851.



The Independent Review, Fall 2011

The Independent Institute in the News

Center on Entrepreneurial Innovation

“If the politicians would put America’s fiscal house in order—by reducing the size and scope of government—they would encourage entrepreneurs to create the kinds of jobs that add value to the economy and, in what economists call a ‘virtuous cycle,’ help generate additional hiring. Another White House jobs initiative is exactly the wrong remedy. With some 14 million or more Americans unemployed, the best jobs program from Washington is none at all.”—Senior Fellow **Benjamin Powell** in *Investor’s Business Daily*

“One thing is certain about the deal reached this week to raise the debt limit: Deficits aren’t going away. Even if the deal is fully implemented it will not bring the U.S. budget into balance. Deficits will continue to increase as will spending.”—Research Director **Alex Tabarrok** in *Time*

“One of the biggest roadblocks to liberty and prosperity is the notion that government can improve on market outcomes, even if we acknowledge the possibility that markets won’t produce perfect outcomes or that there will always be bad people doing bad things.”—Research Fellow **Art Carden** in *Forbes*

“Washington is injecting uncertainty and instability into an economy that otherwise can be quite resilient in the face of change. Many businesses are doing well and making profits. But the economy isn’t growing because businesses are uncertain about how to best use those profits and other resources.”—Research Fellow **Emily Skarbek** in *The Sacramento Bee*

“The president seemed unaware that private companies and entrepreneurs, rather than government, have provided much of America’s infrastructure. And they could do so again, rather than asking our cash-strapped governments—and tapped-out taxpayers—to foot the bill.”—Research Fellow **Gabriel Roth** in *The Daily Caller*

Center on Peace and Liberty

“To solve the enormous fiscal crisis facing the United States, America needs to bring its troops home. The vibrant blessings of American liberty can be restored only when the U.S. ends its invasive wars and restores its constitutional republic of limited government.”—Independent Institute President and Founder **David Theroux** in *The Christian Science Monitor*

“Rather than risking the lives of more Americans and spending more U.S. taxpayer dollars to rebuild the Afghan nation, the U.S. government should be looking to disengage—now, rather than later. As long as the United States remains in Afghanistan, the call for jihad will continue. This does create a threat to the United States

and marks America as a prime target for terrorism. There is little we can do about corruption. There is much we can do to remove the bull’s-eye from Uncle Sam’s chest.”—Senior Fellow **Charles V. Peña** in *The San Francisco Chronicle*

“The Bill of Rights does not distinguish between normal criminals and traitors, nor even citizens and non-citizens—instead, it requires that ‘no person . . . be deprived of life, liberty, or property, without due process of law.’”—Research Editor **Anthony Gregory** in *The Huffington Post*

Correction: In our previous newsletter, the following quote should have been attributed to Robert Koehler, syndicated writer with © 2011 Tribune Media Services, Inc. who was describing **Anthony Gregory’s** work: “As **Anthony Gregory** of *The Independent Institute* recently pointed out, **Barack Obama**, despite riding into office on a huge ‘end the war’ vote, has not only embraced but expanded the **Bush** policy of preemptive war—revving up our presence in Afghanistan, widening the war into Pakistan, dramatically increasing our drone attacks and, most recently, launching an undeclared war in Libya.”•



Independent Institute Senior Vice-President Mary L.G. Theroux on Fox Business News’ “Freedom Watch.”

New Book

Ending Defense Subsidies for Oil Imports

The United States gets only about 10 percent of its oil from the Persian Gulf, but it spends more than \$334 billion per year on defense in that region. If that amount of military spending were incorporated into gasoline prices, U.S. consumers would pay \$5 more per gallon of gas, according to one estimate.

The exorbitant costs of U.S. oil policy should motivate Americans to reexamine their basic assumptions about oil and security. Those who do so will find a treasure trove of useful and fascinating information in *No War for Oil: U.S. Dependency and the Middle East*, by Ivan Eland, Senior Fellow and Director of the Independent Institute's Center on Peace and Liberty.

According to Eland, the notion that the United States must spend vast sums on a military machine poised to secure access to oil with all the destructive force that modern technology can muster—an idea shared by all U.S. presidents and their advisors since at least World War II—is wrong, *dead wrong*. It has led to costly and unnecessary wars with massive losses of human life and

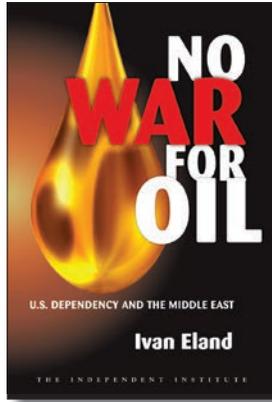
has eroded liberty at home. In truth, Eland argues, the free flow of oil to the United States does not require U.S. military protection of the Persian Gulf or other oil-rich regions: Americans can rely on markets alone to deliver fuel, just as they rely on markets to provide Big Macs, iPhones, and SUVs.

No War for Oil is organized in a way that makes its complex subject matter both intelligible and engaging to a diverse audience. Part I examines the history of oil and the use of military power to control supplies, from the two World Wars to the turbulent 1970s to the Iraq War.

Part II rebuts eleven influential myths about the market for oil. Eland shows, for example, that “Big Oil” does not collude with OPEC to stick consumers with higher prices. Nor, he explains, would “energy independence” make Americans more secure and prosperous.

Part III argues that there is no need to use military power to safeguard foreign oil, even in the turbulent Middle East. Eland's iconoclastic insights shine particularly brightly as he scrutinizes claims about general and specific “threats”

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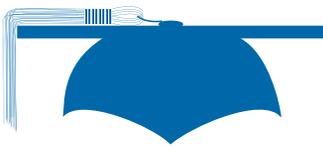
Student Programs

Institute Student Programs Robust and Growing

The year 2011 was a groundbreaking one for Student Programs at the Independent Institute. With our redeveloped **Challenge of Liberty Summer**

Seminar conferences, led by Seminar Director Greg Rehmke, we hosted a record 57 attendees. Plus, we hosted an outstanding class of 11 interns.

In June, 34 students attended our Challenge of Liberty high school seminar, representing private, public, and home schools from across the region. Our college seminar in August, hosted at the campus of Notre Dame de Namur University in Belmont, CA, attracted 24 students from 6 countries and 16 universities, including Francisco Marraquin University and the University of Prague. With our great lineup of Independent Institute fellows,



headlined by **Senior Fellow Robert Higgs**, we expect the 2012 Summer Seminars to be even better!

In addition to our seminar program, the Independent Institute hosted 11 interns throughout the year in Development, Publications, Acquisitions, Communications, and Marketing. Our interns are given the opportunity to work on important projects while learning about their field of interest and the principles of free societies. These interns, from schools such as U.C. Berkeley, University of Chicago, and Boston University, represent the best and brightest young minds leading the studentliberty movement.

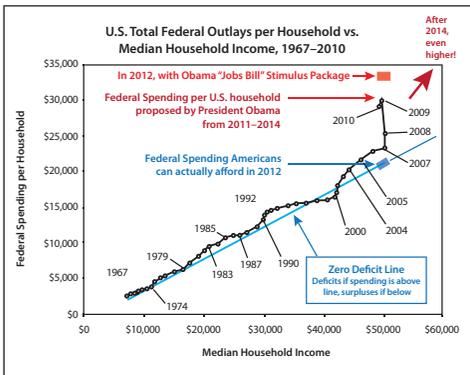
Internships are available year-round, so make sure to apply today!•

MyGovCost

What Can Be Done About the Deficit Gap?

How much can the typical American household afford for the U.S. federal government to spend? What should the President and Congress do to address the Deficit Gap?

Now that the median household income data for 2010 has been tabulated, we can update our analysis at MyGovCost.org: **The Government Cost Calculator** to track the historical trend of increasing government spending and the consequential burdens this trend places upon the typical American family. The results are illustrated below:

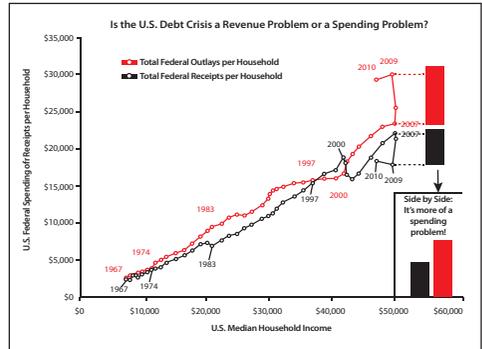


Historically, federal outlays per household have increased in line with median household income, but starting in 2008 household income stopped growing and federal spending took off.

Recently President Obama described his plans for future spending in the Mid-Session Review of the Budget of the U.S. Government for Fiscal Year 2012, which runs from October 1, 2011 through

September 30, 2012. As noted on the chart, his new “Jobs Bill” Stimulus Package would increase the gap even more.

Looking at data for federal spending versus federal revenues, we can determine the real implications of current spending proposals for the American taxpayer.



While federal revenues per household have slipped during the Great Recession since 2007, we find that excessive spending by the U.S. federal government in the years has jumped and is primarily responsible for the current debt crisis, representing approximately 62 percent of the Deficit Gap.

While the economy can recover in time if allowed to, the federal government cannot precisely control the amount of its tax receipts from year to year. On the other hand, it is more than fully capable of controlling the amount of its spending and reducing the Deficit Gap. •

Policy Forum

Hot Talk, Cold Science Author Talks Global Warming

Is global warming caused more by the burning of fossil fuels, or more by natural processes? Why do the predictions of greenhouse models diverge from temperature data gathered from the atmosphere?

On July 14, atmospheric physicist **S. Fred Singer** discussed these questions at the Independent Policy Forum, “Hot Talk and Cold Science of Global Warming.” In essence, Singer argued that failure of climate models suggests that natural processes matter more than human activities.

The reason for the models’ failures, said Singer, might be that they don’t yet incorporate little-understood phenomena such as (1) oscillations between the atmosphere and oceans, and (2) solar



emission of particle streams and magnetic fields—two natural processes that some researchers believe may hold the key to climate change.

Watch a video of this event at www.independent.org/multimedia/detail.asp?m=2. •

Vern McKinley: Government Bailouts: Financing Failure

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response to the 1980s crash was to deregulate and tear down arbitrary government restrictions on banking ownership. Major Texas banks, with state banking-industry support, persuaded the governor to call the Texas legislature into special session in the summer of 1986. The legislature passed an interstate banking law and approved a public referendum in the November election to amend the state's constitution to permit limited branch banking. The interstate banking law took effect on January 1, 1987, allowing private deals to occur.

The Texas economy has done well since the 1990s, rebounding and stabilizing in the wake of these changes. There are many reasons for this, but the short answer is that Texas was willing to sacrifice short-term comfort for long-term sustainability and endured through the difficult adjustments to rebalance its economy: unemploy-

ment spiked, the economy became more diversified, hundreds of companies filed bankruptcy, and the above banks were allowed to fail. In the aftermath of these wrenching changes, unemployment is now well below the U.S. average and Texas has the strongest economy of the largest states in the nation. As was the case in Texas during the 1980s, when the state responded to big banks approaching failure by shutting them down and opening up the banking system, the economy recovered more strongly. That result is one that Geithner and Bernanke's theory would have a hard time explaining, but is nevertheless the most productive recipe for recovery that the federal government should follow to reverse the ongoing economic malaise.

For more details on the Texas economy in the 1980s see www.tshaonline.org/handbook/online/articles/czbo1.

New Book: Ending Defense Subsidies for Oil Imports

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to oil supplies abroad. The bottom line: Without Uncle Sam's generous help, Persian Gulf oil producers, shippers, and consumers (the latter residing mostly in Europe and East Asia) would have strong financial incentives to protect the free flow of oil.

Part IV offers guidelines for U.S. policy. These include relying on markets to provide oil even during a crisis; hastening the withdrawal of the U.S. military from the Persian Gulf in order to reduce hostility toward the United States; and, at the very minimum, encouraging other countries to share the burden of safeguarding the flow of oil from the Persian Gulf.

Slashing the U.S. military presence in the Persian Gulf, Eland stresses, would save American lives and reduce the financial burdens imposed on American taxpayers at a time when the huge economic, political, and human costs of a sprawling U.S. military presence abroad are becoming increasingly evident.

"In short, going to war for oil is unnecessary, expensive in blood and treasure, and dangerous for U.S. security," Eland concludes.

Praise for *No War For Oil*

"No War For Oil is a tour de force of history, myth-busting, and sturdy policy analysis. This book could not be more valuable or more timely."

—**Michael C. Munger**, Professor of Political Science, Duke University

"In No War For Oil, Ivan Eland shows that U.S. dependence on oil is no big deal; that thinking otherwise has led to huge costs, including at least one war; that we are not running out of oil; that a free market in oil is the best energy policy; and that oil is incredibly cheap compared to the alternatives."

—**David R. Henderson**, Research Fellow, Hoover Institution

"Ivan Eland has produced a devastating indictment of the 'oil rationale' for the intrusive, counterproductive U.S. military presence in the Middle East."

—**Ted Galen Carpenter** Senior Fellow, Cato Institute

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Your Year-End Planning for Liberty

The approaching end of the year often means not just planning for holidays and contemplating New Year's resolutions, but also for annual gifting and tax planning.

For 25 years the Independent Institute has produced award-winning, peer-reviewed studies that have shed light on the causes of and solutions to critical issues: the "ratchet effect" of the growth of government through crises; "regime uncertainty" as the explanation for why businesses are hesitant to invest and create jobs; prescient analysis of the global financial meltdown and continuing government failures; the **MyGovCost**.

org website on runaway government spending and debt and what should be done about it, and much, much more.

The Institute has produced books, conference and media projects, web-based resources, and seminars that have trained thousands of students in thinking critically about the fundamentals of personal and economic liberty. Our non-politicized studies and solutions stand up to the severest scrutiny—with not *one* having been refuted in our entire 25 years! And all at a tiny fraction of the cost of *any* other major policy organization.

An investment in the Independent Institute is leveraged for enduring impact, across the political spectrum. Our studies are not lightly dismissed as representing some vested interest: scholars and media alike recognize that the Independent Institute's imprimatur stands for compelling, thoughtful, and rigorous proposals that redefine debate and deserve—and get—serious consideration.

As you contemplate your year-end giving, please consider making a tax-deductible contribution that will pay off far beyond the next Tax Day: an investment in an Independent Institute project that could well be the next study whose findings remain as relevant and referenced 25 years from now as they are today!

With this year's wild stock market swings, you may also wish to rebalance your portfolio. As you know, gifts of appreciated stock allow you to deduct the full current market value, without realizing capital gains; and if it's time to get rid of some holdings that have declined, taking a capital loss and gifting the proceeds can provide double year-end value, offsetting other gains you may have, as well as providing a charitable deduction.

Please contact Development Manager **Sarah Tarvin** to discuss gifts of stock, or any other questions you may have, at 510-632-1366, ext. 152 or STarvin@independent.org. To give by credit card or check, please use the enclosed reply envelope, or visit our Donate web page at www.independent.org/donate/. Thank you for your consideration, and Happy Holidays!•



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