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Telos PRIMO PIANO SCALA c

Prof. Jeffrey A. Miron, economist, is amongst the most passionate and prominent critics of the bail-out system and the fiscal stimulus package proposed by the Obama administration. His specialisation is Libertarianism. In his latest book, *Libertarianism, from A to Z*, he uses his clear and geometrical arguments to makes us understand, definition after definition, the meaning of being in favour of a strict limitation of political power. Senior Lecturer and Director of the Undergraduate Studies Department of Economics at Harvard University, for the last six years Miron has been head of the Economic Department at Boston University. In 2005 he published an important study entitled *The Budgetary Implications of Marijuana Prohibition,* and concluded in favour of decriminalisation. Students consider Miron their favourite celebrity. In the last five years he has been listed amongst the preferred professors of final year students at Harvard. In four years, 800 students enrolled in his course entitled *A Libertarian Perspective on Economic and Social Policy.* He writes on the blog: jeffreymiron.com

Editorial

21 October 2010: The European Commissioner for the Internal Market Michel Barnier launched a new idea into the political arena; he reflected on the possibility of letting banks, even large ones, go bankrupt and avoid making citizens pay, as they have done for the last two years in the United States and Europe. The objective? To stop having to choose between the catastrophe of unorganised bankruptcy and a bail-out with public money, and overcome the *too big to fail* issue. There are multiple implications in this approach and this is certainly not the right place to discuss them, but we are sure that, on the other side of the Atlantic, someone must have thought: finally! This has been the argument put forward by the American economist Jeffrey Miron, this month's protagonist of Primo Piano Scala c; since the 2008 financial crash he has always maintained that State intervention can create inequality. An almost solitary voice, at that time, he continued to stress the need to at least limit government intervention and prevent broadening the public perimeter.

Those who advocate this approach are called *libertarians* because, in the words of the Austrian economist Joseph Alois Schumpeter, in the Anglo-Saxon world the enemies of the free market have appropriated the word liberalism. In America, where liberal stands for social democrat, the word libertarianism is used. Miron, a libertarian from Harvard, is sceptical, to say the least, about State's attempts to be arbitrator and controller of the competitive game; in a free market, he argues, no one should be awarded special privileges from the Government. Miron maintains that during the crisis no bail-out was granted based on the principle of equality, a key market element, and that the emergency logic only spawned an expansion of the powers of the State. Miron suggests that, before bailing-out, governments should have tried to imagine the possible scenarios, from at least three viewpoints: impact on wealth distribution, economic efficiency, and the duration and severity of short term wealth depletion. On the contrary, bail-outs subverted the fundamental rule of the market: you break, you pay. It's a short step towards responsibility. Corporate responsibility is one of the key principles of Telos' philosophy. In fact, Miron tells us that bail-outs have robbed the word risk of its truest meaning, i.e., to personally be responsible for bad choices. The right to choose means accepting to pay the price for those choices, i.e., responsibility. *Responsibilitarism* doesn't sound good, but it could be the right word for a political philosophy that continues to consider companies (and people) as adults, and not children who take risks because there's always someone who will pick up the pieces.

Mariella Palazzolo

Jeffrey Miron: A solitary voice crying in the wilderness. Too big to fail? NO.

Telos: First not to harm. This might be the responsible Libertarianism motto. What can be today's thoughtful application of the libertarian perspective in economy and finance?

Jeffrey Miron: The libertarian view is that government should intervene only when two conditions hold: 1) convincing evidence suggests that private mechanisms will fail badly; 2) convincing evidence suggests that the benefits of intervention are greater than the costs and its consequences (also the unintended ones). The libertarian knows how such conditions rarely hold. This does not mean libertarians assume all private arrangements work *perfectly.* Libertarians agree that externalities, public goods, monopolistic behaviour, myopic consumers, and other departures from an idealised economy exist. They believe these problems are relatively unusual and modest in size, while private mechanisms often develop to help ameliorate any deficiencies of private arrangements. Even more strongly, libertarians know how imperfect private arrangements might be, but they believe that, however well-intentioned governments might be in intervening, their policies aimed at *fixing* social and economic problems are likely to be ineffective in accomplishing their stated objectives and are likely to create unintended, negative side effects. In a few words: even if private arrangements work badly, government interventions are a treatment that is worse than the disease.

Too big to fail **is the title of one chapter of your latest book, *Libertarianism* from A to Z. Back in September 2008 you defined the US government's $700 billion bail-out of Wall Street a *terrible* idea. Why?**

The bail-out was a bad idea because it rewarded excessive risk-taking and thereby encouraged moral hazard: the tendency for private agents to take on excessive risk when they know they will not pay the full costs if things go badly. It is a real paradox: bail-outs reward mismanaged companies and create moral hazard. They subvert the fundamental market rule, i.e. *those who break pay.* This rule is an essential complement of freedom. Nor do new regulations give great hope. They seem to be the counterpart of the *special status* granted to those financial firms which are too big to fail, otherwise crippling systemic effects would occur. If the Government had not bailed-out Wall Street, it is likely that many financial firms and banks, in addition to Lehman Brothers, would have failed. This outcome, by itself, would have been a good thing: the essential aspect of capitalism and free markets is that inefficient, incompetent, or otherwise *bad* firms are driven out of business. Advocates of the bail-out claimed that financial institutions are *special* and that widespread failure of these firms would have caused a credit crunch and thereby generated negative spillovers to the rest of the economy. Is it possible scenario? Yes, it is. Without question, financial markets would have been chaotic had Treasury and the Federal Reserve (Fed) not intervened. But any short-term stability these interventions

> The real paradox is that bail-outs and incentives reward mismanaged companies and create a moral gamble. This kind of government intervention amounts to picking winners and losers in the economy, an activity at which governments routinely fail; it also sets the stage for *crony capitalism*, where *well-connected* and politically *savvy* firms become the ones that succeed in the *political* marketplace.

might have achieved comes at a huge long-term cost: major financial firms will forever more assume that their risky bets are backstopped by taxpayers. More broadly, the bail-out sets a precedent for much expanded intervention of government in asset markets: buying and selling particular classes of assets, as the Fed has done with mortgage-backed securities; compensation limits; and pressure on financial markets to support particular kinds of activity, such a green energy or low-income housing. This kind of government intervention amounts to picking winners and losers in the economy, an activity at which governments routinely fail; it also sets the stage for *crony capitalism,* where *well-connected* and politically *savvy* firms become the ones that succeed in the *political* marketplace.

Exactly two years have gone by and the new Obama administration has approved a stimulus package. Are you still convinced of your previous statement?

I have been sceptical from the beginning of the benefits of government stimulus, especially one based on spending rather than reductions in marginal tax rates. We do not know how bad things would have gotten without the stimulus, so we cannot say for sure that it did not help. But the economy's performance since the stimulus has certainly not lived up to claims made on behalf of that stimulus. Several considerations, moreover, suggest that stimulus can harm economic recovery. Any stimulus projects that do not meet standard cost-benefit criteria for improving economic productivity are bad for the economy, and the likelihood of such projects is substantial when significant additional spending is adopted in haste. Stimulus ultimately requires additional taxation, and this taxation distorts economic incentives and reduces economic productivity. More broadly, stimulus and other government attempts to manage the economy are likely to increase uncertainty, delay needed adjustments in the economy's structure, and encourage reliance on government rather than private mechanisms that, ultimately, may work better than government policies.

Reductions in marginal tax rates would have been a far more effective kind of stimulus. These cuts are entirely consistent with the Keynesian argument for stimulus, and they have the added bonus of improving economic incentives. Lower capital income tax rates, in particular, would stimulate investment and therefore hiring. It would have attracted capital from overseas. And it would have had modest impacts on deficits because of the beneficial one on economic productivity.

In spite of some optimistic views, the world is still facing a financial and economic crisis unlike any seen before. How we respond will shape our future for many years to come. Which is the road to be taken?

I do not think financial crisis is the principal obstacle to economic prosperity; it is the runaway growth of entitlements and therefore national debts. These promise to generate fiscal meltdowns in a broad range of countries. The United States and Europe have two approaches they can take to reining in their debt. The first is higher taxes; this is unlikely to be effective because higher taxation will slow growth and generate limited increases in tax revenue. The second approach is reduced expenditure. This approach can both slow the increase in national debts and stimulate economic productivity by reducing the adverse incentives created by generous retirement and health insurance programs. In many cases these programs are counterproductive and need to be cut back, independent of any concern about deficits. The ideal reductions in entitlement spending would improve the structure of economic incentives. Some examples? Increasing age of eligibility for retirement and patient contributions healthcare costs, via co-funding and deductibles. These changes make sense independent of the fiscal outlook.

The debate on super-bonuses earned by managers, mainly finance sector's ones, is quite hot today. Such remunerations very often appear to be unjustified in light of the results achieved. Do you believe possible to find a shared notion of ethics in management, that respects both economical and ethical values?

I agree that many compensation packages appear excessive, but the right way to limit excessive compensation is to let *failed firms fail*. The United States and Europe short-circuited this process with the bail-out of Wall Street financial institutions. Policies that target *bonuses* directly will do little to limit compensation because financial firms will find clever ways to circumvent the limits. The attempt to limit compensation is mainly a response to populist outrage over the bail-outs. Only one notion of *ethics in management* makes sense: letting the marketplace drive out poorly performing firms. Single-minded focus on profit-maximisation is not a sin! It leads to the most productive economy and means a larger economic pie for everyone.

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