Where Politics Don't Belong

By TYLER COWEN Published: September 12, 2009

FOR years now, many businesses and individuals in the United States have been relying on the power of government, rather than competition in the marketplace, to increase their wealth. This is politicization of the economy. It made the financial crisis much worse, and the trend is accelerating.

Well before the financial crisis erupted, policy makers treated homeowners as a protected political class and gave mortgage-backed securities privileged regulatory treatment. Furthermore, they allowed and encouraged high leverage and the expectation of bailouts for creditors, which had been practiced numerous times, including the precedent of Long-Term Capital Management in 1998. *Without these mistakes, the economy would not have been so invested in leverage and real estate and the financial crisis would have been much milder.*

But we are now injecting politics ever more deeply into the American economy, whether it be in finance or in sectors like health care. *Not only have we failed to learn from our mistakes, but also we're repeating them on an ever-larger scale.*

Lately the surviving major banks have reported brisk profits, yet in large part this reflects astute politicking and lobbying rather than commercial skill. Much of the competition was cleaned out by bank failures and consolidation, so giants like Goldman Sachs and JPMorgan had an easier time getting back to profits. The Federal Reserve has been lending to banks at near-zero interest rates while paying higher interest on the reserves the banks hold at the Fed. "Too big to fail" policies mean that the large banks can raise money more cheaply because everyone knows they are safe counterparties.

President Dwight D. Eisenhower warned of the birth of a military-industrial complex. Today we have a financial-regulatory complex, and it has meant a consolidation of power and privilege. *We've created a class of politically protected "too big to fail" institutions, and the current proposals for regulatory reform further cement this notion.* Even more worrying, with so many explicit and implicit financial guarantees, we are courting a bigger financial crisis the next time something major goes wrong.

We should stop using political favors as a means of managing an economic sector. Unfortunately, though, recent experience with health care reform shows we are moving in the opposite direction and not heeding the basic lessons of the financial crisis. Finance and health care are two separate issues, of course, but in both cases we're making the common mistake of digging in durable political protections for special interest groups.

One disturbing portent came over the summer when it was reported that the Obama administration had promised deals to doctors and to pharmaceutical companies under the condition that they publicly support health care reform. That's another example of creating favored beneficiaries through politics.

If these initial deals are falling apart, it is only because reform met with unexpected resistance. Even after Mr. Obama's speech Wednesday night, we're still at the point where the medical sector is enshrined as "too big to take a pay cut," which is not so far removed from the banking motto of "too big to fail." In finance and health care, a common political dynamic has created similar trends, namely, out-of-control costs, weak accountability, and the use of immediate revenue patches to postpone dealing with fundamental problems.

Even worse, these political deals threaten open discourse. The dealmaking may be inhibiting some people in health care from speaking out in opposition to the administration's proposals. Robert Reich, who served as secretary of labor in the Clinton administration, deserves credit for complaining about this arrangement, but not enough people are asking where such dealmaking might stop.

The banking sector has been facing similar constraints; if bankers criticize the Treasury or the Fed, they risk losing their gilded cages and could get a bad deal when the next bailout comes. When major economic sectors can be influenced in this way, are we really very far from the nightmare depicted by Ayn Rand in "Atlas Shrugged"?

So if we're looking for a major lesson from our banking mess, it is undoubtedly this: We have made a grave mistake in politicizing the economy so deeply, and should back away now. In health care, the Obama administration should drop its medical sector deals and try to sell a reform plan — in whatever form Mr. Obama chooses — on its own merits. That's not only good for health care, but also good for the American polity. And in the longer run, that will be good for banking, too. If nothing else, without controlling health care costs, the American government will not stay solvent — and that will be the biggest financial crisis of them all.

In short, we should return both the financial and medical sectors and, indeed, our entire economy to greater market discipline. We should move away from the general attitude of "too big to take a pay cut," especially when the taxpayer is on the hook for the bill. If such changes sound daunting, it is a sign of how deep we have dug ourselves in. We haven't yet learned from the banking crisis, and we're still moving in the wrong direction pretty much across the board.

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