



An Open Letter to Arthur Brooks

Arthur, I heard you're retiring from AEI after a spectacular run. Congratulations and best wishes in your future endeavors. However, in reading an "exit interview" with you, by Tim Alberta of *Politico*, I stumbled across what I believe to be a very important and dangerous blind spot in your thinking.

With some trepidation, because the interview with Mr. Alberta was relatively short, I would like to summarize your arguments. The title of the piece was "Americans are Being Held Hostage and Terrorized by the Fringes."

- You call competition a "moral good" and bemoan a "culture that's not trying to win [political] competition vigorously and civilly and respectfully, but rather trying to shut down competition...". I happen to agree with you on this. Discourse has become uncivil.
- You call this "stupid." I agree, again, and you add, "It leads to a flaccid set of political parties...you don't solve problems...you simply build up power structures. So all politics becomes a rent-seeking mechanism: my tribe, your tribe."
- You blame this on the financial crisis of 2008 and cite Reinhart and Rogoff's book, *This Time Is Different*, and three German economists who, in early 2017, published a piece in *The European Economic Review*. Reinhart and Rogoff argue that economic recoveries in the decade after financial crises are slow. The German economists argue that these slow or lumpy recoveries have knock-on political effects.
- You say, "...in the decade after a financial crisis, the knock-on effect over 10 years is not low growth, it's uneven growth. The big thing that happens for 10 years is that you have asymmetric economic growth where 80 percent of the income distribution gets none of the rewards of the growth after the recession." This creates populism – where people blame "immigrants," "trading partners," or "bankers."

- You then blame the rise of Trump, on an "unwillingness or inability of mainstream Republicanism to deal with a lot of misery that was going on. To talk openly about the despair...there's been a 323 percent increase in drug overdose deaths for men my age..."
- You say Congress isn't detached, but, "they don't know what to do, so they didn't do anything." You then say, "nobody has ever figured out this first decade problem. Ever... Politicians say, 'We can solve this; vote for me and I'll solve it.' [But] They can't solve it...they get blamed." "Nobody knows what to do except wait it out." You claim even Milton Friedman in the White House couldn't have made a V-shaped recovery.
- You complain of a deficit of happiness, "When people feel like 'Sh*t, I can't get ahead,' that's when people feel a lot less happy." "The best single way to get rid of all this unpleasantness right now is economic growth that's evenly spread throughout the population."

That's a pretty straight forward argument. If you believe financial crises cause lumpy and uneven distribution of growth, if you think Reinhart and Rogoff understand how economies respond to financial crises more fully than Milton Friedman, no wonder you despair. But this is where you make your fundamental mistake – buying into the Conventional Wisdom narrative about the Panic of 2008.

Like Paul Gigot, Editor of *The Wall Street Journal*, and Speaker Paul Ryan, I think you have a fatally flawed understanding of the financial crisis of 2008 – what actually caused it, why TARP was such a huge mistake, and how big government growth after the crisis is the real cause of slow growth, despair and political turmoil. I know you did not specifically mention TARP, but by citing Reinhart and Rogoff you seem to agree that capitalism itself is flawed and government must fix it.

I vigorously disagree with this logic. I agree with your co-worker at AEI, Peter Wallison, whose book, *Hidden In Plain Sight*, proves that the government itself created the subprime crisis. I also believe that the government's reaction to the crisis, specifically a \$3.5 trillion program of quantitative easing by the

Federal Reserve and a \$700 billion taxpayer funded bailout, not only did not work, but undermined America's faith in free markets and capitalism.

President Bush said after passing TARP, "I've abandoned free market principles to save the free market system." This statement obviously makes no sense. If you believe in free markets, just like if you believe in the Ten Commandments, violating them in order to save them is nonsense. You either believe in free markets, or you don't; you either believe in the Ten Commandments, or you don't. This is not me becoming an "armchair general" after the war, with perfect 20/20 hindsight. A crisis is when a belief system is tested. The Republican leadership in 2008 failed that test.

Compare this to the 1980s. The financial crisis of the early 1980s was bigger, in dollar terms, than the financial crisis of 2008. In 1980, the entire Saving & Loan Industry had negative net capital. On a mark-to-market basis, almost every money center bank was bankrupt due the default of Latin and South American debt. Oil prices collapsed, taking Penn Square, Continental, and other banks down. Over-leveraged, agricultural banks failed as farmland and crop prices plummeted. Yet, the U.S. experienced robust economic growth in the 1980s. There was no decade of lumpy growth.

The reason is simple, Ronald Reagan cut tax rates and regulation, while holding back non-defense government spending. The Fed tightened monetary policy. In other words, the U.S. followed the prescriptions of Milton Friedman and we did get a V-shaped recovery. Yet, Reinhart and Rogoff ignore the 1980s financial crisis, and Kenneth Rogoff said they did so because economic growth didn't suffer in the 1980s. He ignored that financial crisis because it provided evidence counter to his theory. Not very intellectually honest if you ask me.

Slow growth in the past decade is because government ignored the Reagan-Friedman-Hayek lessons – in fact they did the exact opposite. During the Panic of 2008, government did TARP, QE, tax hikes, massive new regulation, more spending and new entitlement programs. That's why the economy is hurting and there is despair in the land.

I believe TARP was the greatest violation of Republican economic principles since Herbert Hoover put tax hikes, Smoot-Hawley tariffs and new spending and regulation in place during the 1930s. Those policies did nothing but deepen the Great Depression. In 2008 and early 2009, the S&P 500 fell an

additional 40% after TARP was passed. TARP did not work. In addition, it was a direct bail out of banks, not mortgage holders. With Republicans in charge (Bush, Paulson, Bernanke), the GOP violated free market principles and bailed out the rich bankers on Wall Street.

In other words, even the GOP didn't have faith in capitalism. By passing TARP they professed faith in government. Once faith in capitalism is undermined, especially by Republicans who have been the historical defenders of capitalism and free markets, it creates the very thing you complain about. If Republican leaders lose faith in free markets, no wonder the public does, too. There is no more competition of ideas. Both sides believe in government.

Then people work overtime to build up "power structures," and "politics becomes a rent-seeking mechanism." When you compete on these grounds, it becomes a battle of "fringe politics." If one union in Greece gets a 31-hour workweek, all unions want one. If banks get bailed out, why not homeowners, or students with loans? If we can't trust banks, how can we trust insurance companies, so why not socialize healthcare? The commanding heights of power moves from markets to government – no wonder the DC area is booming, while despair spreads in the hinterlands.

Not only did Republicans sell out free markets, they paved the way for massive government growth. I understand the difficulties in comparing the two, but isn't opioid addiction (which you use as evidence of economic despair) similar to the excessive drinking of vodka in Russia? Despair is caused by big government, which undermines the vibrancy of free markets and destroys the more even distribution of economic opportunity that you yearn for.

The way to fix the U.S. economy, the best way to create "evenly spread" economic growth and end despair is for government to get out of the way. It takes faith in markets and people, not government.

There are always problems, but when central authorities try to fix those problems, they often make them worse. You are enough of a historian to understand that. Allowing Reinhart and Rogoff to lead you this far down the wrong path creates despair in my heart.

I'd be happy to sit down with you and discuss these issues in greater detail. If you don't have time, or an inclination to do that, please read my 2009 book (which I wrote at the depths of the crisis), *It's Not as Bad as You Think*.