



# COUNCIL FOR NATIONAL POLICY

*Remarks*  
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It is really a pleasure to be here. I always enjoy having the opportunity to talk to business and community leaders who are actively involved in protecting and defending the principles that have made America great.

I recently wrote a book called *The Financial Crisis and the Free Market Cure*. One of the reasons I wrote this book was because the Left, the statist, have done a great job of creating a myth and the myth has been used to justify a lot of bad public policy. That myth is that the deregulation of the banking industry and green on Wall Street caused the financial crisis from which we are still suffering. Now, unfortunately, their myth is not true even though they want to keep acting like it is true. In fact the financial service industry was not deregulated. During the Bush administration we had a significant increase in regulation, three new major regulations, the Privacy Act, the Patriot Act, and Sarbanes-Oxley. And while there is plenty of green on Wall Street, in my 40 year career, I have never seen a time where there was never green on Wall Street. There was no evidence of any more green than usual that created the financial crisis.

In fact, in my book I discuss six basic things. The first, the financial crisis was primarily caused by government policy. We don't live in a free market in the United States. We live in what is called a mixed economy, a mixture that varies a lot by industry. Technology is largely unregulated, and it has done very well. Financial services are the most regulated industry in the world, and that is where we have had our biggest problems. Secondly, government policy created a massive disinvestment in residential real estate, what is called a bubble. The bubble burst, as all bubbles do, destroying millions of jobs and trillions of dollars of wealth. Thirdly, a number of large firms, so called Wall Street, made some serious mistakes. If I had been in charge, I would have let those firms fail. However, those mistakes were secondary and highly incentivized by government policy. Fourthly, and most unfortunately, almost everything we have done since this financial crisis started, even things that have had some temporary positive affect, will reduce the quality of life for our children and our grandchildren and will reduce it in a material way. Fifthly, and most importantly, and what I am mostly going to talk about, the real cause of the financial crisis and the real cure is philosophical, not economic. And finally, we do face a very difficult economical challenge if we do not change direction. What we are doing economically to our children and grandchildren is unconscionable with the current policies we have in effect.

What happened? We invested at least three trillion dollars, arguably eight trillion, too much in residential real estate. We built too many houses, houses that were too big, houses built in the wrong places. We should have been investing in technology, manufacturing capacity, agriculture, and education. We should have saved more and spent less. We should have

borrowed less from foreigners. Over investing in housing, which we are, by the way, trying to incentivize again, is destructive because housing is consumption. You consume a house just like you consume an automobile. So we over consumed. It is analogous with eating your seed corn, and you can't plant next year's crop because you ate it. We ate a lot of capital by over consuming which reduces our future productivity going forward. In addition, in the process we taught millions of people how to do the wrong thing. How to build houses, how to be residential real estate brokers, how to be mortgage bankers and those millions of people have to learn new jobs. How did we make a mistake of that magnitude? It takes government policy to take markets in that wrong direction, and we had two primary culprits. The first culprit was the Federal Reserve. The Federal Reserve, one of their roles - if chosen - is trying to reduce volatility in the economy. What it does in reality, however, is reduce volatility in the short term and create bigger problems in the long term. In a free market, markets are constantly corrected. New businesses are created and businesses are failing. The failure process is as important as the creative process, because when failures happen, human and capital resources get reallocated to something more productive. When you stop the failure process, when you keep the downside from happening, you push the problems into the future. If you are not disciplining a 13 year old, then you will be really sorry when they get to be 16 years old. That is exactly what the Fed is trying to do today, and it has led to massive errors. And then specifically Alan Greenspan, the head of the Federal Reserve and a maestro in the early 2000s, wanted to go out as a hero, so he created something called negative real interest rates. This meant you could borrow at less than the inflation rate in real estate, which incited a huge amount of borrowing in the U.S. economy. Mathematically, we couldn't have a bubble unless the Fed provided the money. It was not possible. The bubble ended up focusing on the housing market primarily because of two large government sponsored enterprises. Freddie Mac and Fannie May would never exist in a free market. The only reason they exist is because the government guarantees their debts. We have been subsidizing housing for a long time, but a pivotal event happened in September of 1999 when President Bill Clinton demanded that Fannie and Freddie, these giant government enterprises, have half of their loans in affordable housing, i.e. subprime lending. Well, they largely met that goal and in the process created a bubble in the subprime lending and affordable housing market. When Freddie and Fannie failed, they owed five trillion dollars and had two trillion dollars of subprime mortgages. They dominated in the subprime mortgage business, and in the process created a massive disinvestment in the residential real estate market. So fundamentally the financial crisis was caused by mistakes made by the Federal Reserve and Freddie and Fannie. Government sponsored enterprises and government policy created the crisis.

But what I really want to talk about tonight is the underlying philosophy that caused those problems and the philosophic cure. The financial crisis was caused by a combination of altruism and pragmatism. Altruism is not benevolence. Benevolence is a very good thing. What altruism is is otherism: it says that everyone is more important than you. As interpreted by state, it says that the collective matters and the individual does not matter. Everybody has a right to a nice house. Provided by whom? Everyone has a right to free medical care. Provided by whom? My

right to free medical care is the right to force a doctor to provide that medical care or force somebody else to pay that doctor. That is exactly the opposite of the American concept of rights. In the American concept of rights you have the right to what you produce, what you create. You do not have the right to what someone else produces, what somebody else creates. Businesses like to talk like they are altruistic in their ads, but there are no altruistic businesses in a globally competitive market. The backup philosophy in business is called pragmatism. And the rule in pragmatism is to do what works. Here is the dilemma --- a lot of things that work in the short-term are destructive in the long-term. Affordable housing and subprime lending worked for years, and then it was an economic disaster. There is also a problem seen in politics with being a pragmatist: you really can't be rational because rationality demands a long term perspective, and you can't have integrity either. Integrity is acting consistent with the principles. Define altruism and pragmatics and you get something I call the free lunch mentality. Social Security and Medicare are huge problems and yet nobody has really offered the serious painful solutions to deal with them. The free lunch mentality leads to a lack of personal responsibility, and a lack of personal responsibility is ultimately the death of democracy. In fact the central issue in our society, the number one issue, is personal responsibility. I talk a lot on college campuses, and I ask these students, are you responsible for yourself or are you entitled to what somebody else produces? And here is one of the ironies about entitlement. Those of us who pay for entitlements --- I expect most of you do pay --- we feel like the victims. And we are the victims, but in a very superficial way relative to those people who think they are entitled. Because if you think you are entitled, than you are dependent on somebody else and you actually give up the opportunity to earn happiness. You see, entitlement mentalities are self-destructive. The founding fathers talked about this, and they were talking mostly about the abuse of individual rights like freedom of speech and religion. But they realized that when 51% of the people could vote a free lunch for 49%, pretty soon the party was over. Because pretty soon 60% want a free lunch from 40%, and then 70% want a free lunch from 30%, and finally the 30% quit. Just like the cause was philosophical, so was the cure. And the cure was expressed eloquently by Thomas Jefferson in the Declaration of Independence, "life, liberty, and the pursuit of happiness," your fundamental right to your own life, your fundamental right to the pursuit of your own personal happiness, and your fundamental right to the product of your labor. If you produce a lot, you get a lot. Including the right to give away, do whatever you want, for whatever reason you want to. If you think about that moral purgative, it demands personal responsibility, because there is no free lunch. It also demands and rewards rationality, it demands and rewards self-discipline, it demands and rewards integrity, and they all flow from that fundamental concept of "life, liberty, and the pursuit of happiness." Liberty, it is interesting, even statist talk about liberty, but few people have really reflected on why liberty is so important. Obviously it is nice to be free, but liberty is a lot deeper than that. Everything that is alive has a method of staying alive. A lion has claws to hunt, a deer has speed to avoid the hunter, and we have the capacity to think. And our capacity to think is literally our only means of survival, success, and happiness --- no short cuts and no free lunches. And there are certain sets of attributes that allow us to think productively, and if you reflect on that there is only one true natural resource, and that is the human mind.

A thousand years ago, what was useless to man? Somebody invented oil, but oil is useless to a deer. Twenty-five years ago telecommunications went through big thick cables made out of copper. It was expensive and rare. Today communications go through fiber optics made out of silicon and sand, the most common material on the earth's surface. Somebody invented fiber optics. There is only one natural resource: the human mind and human beings must be free to think productively. If someone forces you to act consistently with something you don't believe, you can't think effectively. If somebody makes you act like two plus two is five, you literally can't think. Lots of government rules and regulations, particularly in business, force people to act like two plus two is five, and they literally cannot think. Reflect on this: all human progress by definition is based on productivity. Because unless somebody does something better, which will be different, then there can be no progress. Creativity is only possible to an independent thinker. Somebody that thinks like the crowd cannot be innovative, cannot be creative, and cannot contribute to human progress. That is why entrepreneurs are so important. They take the idea of science and engineers and turn them into reality. I'm sure we have a lot of entrepreneurs in this room. Without entrepreneurs there literally is no human progress. That is why socialism and communism is doomed to failure, because it destroys innovation and creativity. CATO just published a very interesting book called *Poverty in Progress*. It looks at human life expectancy. It is a very interesting number. Up to the 1700s, and going as far back as we have any kind of records, human life expectancy was approximately 24 years. We have had a tremendous improvement in human life expectancy all over the planet, beginning in western civilization that started in the late 1700s. It was some kind of profound invention in the late 1700s that changed human well-being, an invention more important than the wheel, more important than fire. It was the invention of the rule of law. It was the invention of individual rights. It was the invention of capitalism. Capitalism has transformed the quality of life on this planet, and it is because, in a capitalist society, people are free to think, to pursue what they believe is right, what they believe is true, and that leads to innovation and creativity. So liberty is nice, but it is not just about nice, it is necessary for human well-being. It is necessary for prosperity.

How about the pursuit of happiness? You know before Jefferson, before the thinkers and the enlightenment, everyone existed for someone else's good. Good of the king, good of the state, or good of the group. Nobody really existed for their own good. Jefferson said that each one of us has a moral right to our own pursuit of our own personal happiness. We are not guaranteed success in that pursuit, but we have that right. That was a world changing idea. Creating the most successful society in history, and interestingly enough, the most benevolent. When people have the right to their own life, they are naturally nicer to other people. In communist and socialist societies, at the end of the day, everybody ends up hating each other because they are all slaves to one another. And I agree with Jefferson, each of us has a moral right to the pursuit of our personal happiness. I want you to reflect on the pursuit of happiness for a second, because if you stand back, that is actually a selfish idea, pursuing your personal happiness, right? I am going to define it in a different way, because selfishness has kind of been misdefined. I'm going to define it as acting in one's rational long term self-interest. We have been given this very

destructive false dichotomy: to take advantage of other people or to self-sacrifice. In fact, a lot of people think of being selfish as taking advantage of other people. Here is the irony. Taking advantage of other people is not selfish; it is self-destructive. It is self-destructive for two reasons. First, you might fool Tom, Dick, and Harry, but they are going to tell Sue, Jane, and Fred, and nobody is going to trust you. Trying to take advantage of other people means you're not trusted. If you are not trusted, you are not going to be successful, and you are not going to be happy. In addition, at a deeper level, if you spend your time trying to manipulate other people, letting go of reality to try to take advantage of other people, then you are going more damage to your conscience than you are to theirs. Taking advantage of other people is not selfish; it is self-destructive.

How about self-sacrifice? That is a moral code of our society, right? We should self-sacrifice. I want you to ask yourself this question, and if you have children, I particularly want you to think about how you want your children to answer this question. I actually think it is the most profoundly important question you can ask yourself. Do you have as much right to your life as anyone else has to their life? Of course you do. Why would you believe anything different than that? So taking advantage of other people and self-sacrifice, neither one makes any sense. But there is a rigorous demanding moral code that underlies free markets and free societies. It is called the trader principle. Life is really about trading value for value. It is about getting better together. In the banking business, our goal was to help our clients be economically successful and financially secure, and they helped us make a profit doing that. We got better together. Life is about figuring out how to get better together. In fact there are only two stable relationship conditions: win/win and lose/lose. Whenever you get greedy and set up a win/lose, your partner will get bitter, and you will end up in a lose/lose. Unfortunately, you see this in spousal relationships sometimes. Interestingly enough, whenever you get self-sacrificial, and you set up a lose/win, you'll get bitter and you end up in a lose/lose relationship. In any important relationship in your life, you should ask what is in it for me? That is a fair question. But you should also ask, what is in it for them, because if there is nothing in it for them, then at the end of the day there will be nothing in it for you. Life is about creating win/win relationships, and of course it is in your rational self-interest to help the people you care about: your family, your friends, and the people you work with, because you value those people. I use this story with university students. You are getting ready to get married, obviously a big event in your life, and your future spouse comes running up to you and says "Honey, I'm so excited about marrying you. This is the biggest self-sacrifice I have ever made." Not exactly what you want to hear.

I believe that it is in my rational self-interest to support the United Way. The United Way is an umbrella charity organization that does a lot of good in the communities that I live in. I wouldn't want to live in those kinds of communities, and I sure wouldn't want my children to live there without the United Way. So it is in my rational self-interest to support the United Way. Let me give you an interesting challenge to think about what acting in a rational self-interest requires. There is a false idea of what is called selfishness, and that it is taking advantage of

other people, or kind of having this tunnel vision view of the world which is neither rational nor selfish. But what would actually be required to act in your self-interest would first ask the context question which is what kind of world would I like to live in? And then secondly, what would I enjoy doing to help create that kind of world? That would require you to have a sense of purpose; that you do the best that you can do to take care of your body, you eat properly and you exercise well. You do the best that you can do to take care of your mind, you read, study, and think. You work hard to create healthy relationships with other human beings that share your values, because other relationships are very important. What if everybody had a sense of purpose and did the best they could to take care of their bodies, their minds, and worked hard to create healthy relationships? What if everyone were selfish in that rational self-interest context? I would argue that 90% of the world's problems would go away. You know people keep describing and saying that the problem with the world is that everyone is selfish. In my observation there are very few people who act in their self-interest. Most people are self-destructive. I had a brother-in-law that drank 24 beers a day, got cirrhosis of the liver, still drank 24 beers a day, and died. People say he was selfish. That was not selfish, that was self-destructive. Bernie Madoff, the guys who stole billions of dollars from his family and friends, did that for 30 years. The best day in his life, he says, is when he got caught. Can you imagine spending all your time stealing from your family and friends? I think it is critically important that we be able to defend the pursuit of happiness which is an individualist, especially American idea. And to defend it in the context of pursuing ones' rational self-interest properly, as understood as a purposeful and meaningful life, that we will have a much happier society and a much more successful society.

Here are a couple quick comments on economics, because a lot of people ask me about it having been a banker. I think we are in some kind of muddling economic recovery, and I don't know how long we keep muddling along, but I am personally really worried about the long term. What we are doing to our children and our grandchildren is economically unconscionable. At CATO, we are running some numbers to put together a balance sheet and income statement for the US Government, as if it were a business. The preliminary numbers are pretty darn scary. We have a negative net worth of 40 trillion dollars, and if we were accruing properly like a business has to do for post-retirement, Social Security, health care or Medicare, we are losing two trillion dollars a year, and it gets worse. If we continue with altruism and pragmatism, free lunch mentality, lack of personal responsibility, it does not end well. People ask me if it is hopeless. No, I don't think it is hopeless. Actually, mathematically, we can fix it, but we have to drive a much more radical growth rate in the economy, and we can't fix it without some pain. I use the analogy with medicine. We've been identified as having a kind of cancer that, if not treated, is terminal. The good news is that it is treatable, but the tough news is the treatment is chemotherapy. And the real question is: are we willing to take the chemotherapy that is necessary to do the right thing for the long term? I don't have the answer to that question, but I do have hope in two categories. First, the very important good news is that we know what to do. Fixing the problem in a certain conceptual sense is really pretty easy. We need to return to the principles that made America great in the first place: limited government, free market, lower taxes, less regulation, the

basics, and we need to unleash the tremendously powerful entrepreneurial spirit of this country. If we do this, we can drive faster growth, and we can deal with a lot of our problems. We know how to fix it. The second thing is while the last election was a little discouraging in this regard, I still think Americans sense of life is a very powerful force in our society, and I think it is unique. And in that context I want to share with you a thought. If you reflect on it, the end purpose in life is happiness. I don't mean happiness as having a good time on Friday night, but happiness in the Aristotelian sense, of a life well-lived. Hard earned blood, sweat, and tears happiness. When you are 80 years old, and you look back and say, man that was hard, and I'm glad I did it. That is the end game in life. Sometimes business people get confused, they think money is the end of the game. There is nothing wrong with money, money is a very good thing, but money is not an end. It is a means to an end. The end is happiness. The foundation for happiness is real self-esteem, not fake self-esteem. I want to share with you a couple of thoughts on self-esteem, which is actually a very complex subject. First, self-esteem is fundamentally self-confidence in your ability to live and be successful given the facts of reality. So you earn self-esteem by how you live your life. Nobody can give you self-esteem. You cannot give your children self-esteem. Self-esteem has to be earned. Live your life with integrity, you raise your self-esteem. That is why integrity is so important. The second thought about self-esteem for everybody in this room and for the vast majority of people on this planet: the single biggest driver of your self-esteem is your work. Because you spend a disproportionate amount of time and effort and energy at work, and I use work in the broadest context. Raising children is very hard, productive work. Work is important because it drives your character. Something I have said to the employees of BB&T many times over the years is that it's really important at BB&T that you do your job well. But it is far more important to you. You might fool me about how well you do your job. You might fool your boss about how well you do your job, but you will never fool you. If you don't do your work to the best you can possibly do it, given your level of skills and knowledge, you can't do the impossible. But if you don't do your work the best you can possibly do it, you will lower your self-esteem. Good news, the flip is also true. If you do your work the best you can possibly do it, given your level of skill, given your level of knowledge, you will raise your self-esteem, which is more important than getting more money or a promotion, because it is about your character. It is about who you fundamentally are. And that has big social implications, or what I would call the character of America. Take a construction worker that has a tough life. My granddad had that kind of life, a tough, demanding life. Yet, he had a successful life. He and his wife raised their children, maybe their granddaughter becomes CEO of a public company or maybe not, they have a tough life, but they get something very precious from their work. They get to be proud of themselves. Take that same construction worker and give him welfare. He may have more money, but he loses something incredibly important: he loses his self-esteem and his pride. You know, the statists are selling something that is appealing in America today: security. It is a false sell, because they can't provide that kind of security, but that is what they are selling. But the United States is not the land of security. People didn't get on a boat and come to Jamestown to be secure. The United States is the land of opportunity, the opportunity to be great, the opportunity to fail and try again, but most importantly the opportunity for that brick layer to live life on his own terms, to pursue his

personal happiness, given his beliefs and values, to pursue his personal happiness as a free and independent person. That is why people came to America. That is what made America great. And that is what is so precious for us to defend. Thank you very much.