Financing Failure: A Century of Bailouts

Vern McKinley

Oakland, California: Independent Institute, 2011 (381 pages)

If a book is evaluated by considering how well it accomplishes its purpose, Vern McKinley’s book deserves a very favorable nod. McKinley’s goal is to focus on policy issues underlying the US government’s 2008–2010 interventions in the financial system. By revealing flaws and incongruities in the process by which regulatory policy is applied to financial crises, McKinley shows that those who urge more of the same do not have the right answers.

According to McKinley, US government officials and their media operatives painted the financial crisis of 2008–2009 as unprecedented in danger. Purportedly, the crisis created such extreme contagion risks among large financial institutions that government officials had no choice but to trump market autonomy. Allegedly, the impending collapse of the financial system would have produced a severe economic disruption. It was this “all will be lost” false narrative that allowed big government to further deprive markets of vestiges of independence (2–3, 197).

McKinley begins with the March 2008 collapse of Bear Stearns. After highlighting the federal government’s arbitrary handling of the Bear Stearns problem, the author provides an educative chapter on the bailout process as applied to financial institutions. Thereafter, he jumps back to the Great Depression era (1930s) and the regulatory reactions of the 1980s and 1990s, highlighting the growth of dubious regulatory intervention.

For the bulk of his work, McKinley examines the current period, scrutinizing financial interventions by the US Federal Reserve, the US Treasury, the Federal Deposit Insurance Corporation (FDIC), and the US Congress in the form of the Dodd-Frank Act. By providing samples of the policymaking conversation accompanying government acts, the author
highlights a seat-of-the-pants approach to crisis mitigation, politically justified by the notion that no playbook exists when new exigencies appear (299, 305–8). Notwithstanding the ad hoc nature of the interventions, each new government action enlivened market expectations of further financial backstops and bailouts. Consequently, with Bear Stearns in the rearview mirror, moral hazard was seated at the wheel (143–44).

The author disbelieves the crisis narratives concocted by the nation’s largest financial institutions, federal regulatory agencies, and politicians. He believes these actors have overlapping incentives to ignore alternatives to big government interventions. It troubles him that most of the top selling books written on the 2008 financial crisis assume the essential nature of government bailouts. Consequently, he wants to focus attention on the preferentialist nature of government interference with markets.

McKinley claims that the false narrative is perpetuated by a tripartite coalition of self-interested participants: cafeteria capitalists, power-hungry regulators, and shortsighted politicians. His assessment is similar to the political science concept of iron triangles. Long associated with stalemate and bureaucratic sclerosis, these problematic power relationships between congressional committee elites, high-level lobbyists, and senior regulatory bureaucrats result in economic inefficiencies, the exploitation of the public interest, unsustainable taxation and spending, and tragedies of the commons. Both concepts emphasize the hazards of big government and what amounts to regulation-empowered graft.

*Financing Failure* is not an easy read because the underlying story of regulatory jostling is a bit complex for those uninitiated in bureaucratic strategies. While the fact-finding and data-reporting method McKinley employs is consistent with the established norms of academic journals, this approach segregates the ribs of analysis from the backbone of the thesis, allowing McKinley to escape the necessity of demonstrating the connection of components to the overriding conclusion. It is like saying, “These fifty observations when considered as a whole show that constructive and efficient financial regulation is unattainable.” This works for McKinley because he believes “it is government that is at the core of the initiation and worsening of financial crises” (312). While that may be true on many levels, it does not demonstrate the impossibility of dramatically different governmental approaches. No one walked on the moon until Neil Armstrong set foot there.

Arguably, a different set of circumstances could provide regulatory opportunities more amenable to positive outcomes. If market architecture were designed to allow contributions to the sustainable public good to earn the best rewards, the regulation that went with it would be less prone to subsidize crony capitalism. Granted, a new architecture would require a prudent national ethos and genuinely moral culture. It would diminish the place of the stock market as an expansive betting pool. Freed from the expansionary imperative, tired surrogate vehicles of capital management could be replaced with direct investment initiatives that generate jobs based on productivity enhancement and the efficient linkage of prudent demand with supply.

The trouble is not the idea of relatively free markets but the assumption that free markets cannot bear the stamp of a *different original design* that broadens opportunities for grassroots capital accumulation, thus facilitating the well-being of the many. Perhaps
conversations about alternatives to regulation have become moldy by the polarization of camps—some supporting big government regulation while others hold to traditional laissez faire views.

Criticisms aside, there is an important attraction to McKinley’s approach. By going light on analysis until the last chapter, McKinley unclutters his narrative, generating a fairly unvarnished account that readers can decipher as they see fit. The utility of the work is helped by McKinley’s clear prose, careful organization of the material, utilization of actual conversations among policy players, and a rich treasure trove of detailed footnotes.

In sum, *Financing Failure* provides a credible, articulate, and fairly comprehensive description of the evolving yet patterned establishment approach to financial regulation in the United States. The discussion assembles important evidence supporting the thesis that the existing regulatory paradigm is deeply flawed. The faults pertain not merely to correctable bureaucratic inefficiencies and maladroitness but a policymaking approach that burnishes its elitist discretion in the midst of financial crises. As a result of this approach, the wealth generating capacity of the nation works to disproportionately benefit a privileged few—often the people who are least deserving of outsized rewards, all things considered. Thus viewed, McKinley’s work helps guard against the notion that big government solutions are essential in unstable times. This timely book serves the public interest. It deserves an educated audience.

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**Economies of Salvation: Adam Smith and Hegel**

**Yong-Sun Yang**

Bern, Switzerland: Peter Lang, 2012 (213 pages)

In *Economies of Salvation*, Yang hopes to correct the “generally” held view that theology and economics are not related by demonstrating that the economist Adam Smith relies heavily on theological notions of salvation, grace, and providence and that the theologian Hegel’s notion of the “cunning of reason” applies to self-interest in civil society as a middle step in the progression toward rational self-consciousness. Yang contrasts the two thinkers’ notions of God and his providence, human “self-conscious desire,” human sociality, poverty, and salvation.

Smith understands self-interest to be a providential gift from God to coordinate humans otherwise dogged by weak rational abilities. Furthermore, humans desire salvation because they have self-interest, which can include many *nonselfish* interests. So, fall of man or no, Yang concludes that Smith’s God instills self-interest in humans as their strongest source of motivation. Even our ability to make moral judgments relies on self-interest, because, in Smith’s “sympathy,” we imaginatively change places with the other.

Hegel, on the other hand, sees self-interest as the result of the fall of man, a force that has its part to play in moving us toward individual self-consciousness in civil society but that must be transcended in the ethical life of the state.