

## **Meet the Street: An Economist Argues Against Federal Bailouts**

*By Lee Barney, Staff Reporter*

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Requests for federal bailouts of industries damaged by the Sept. 11 terrorist attacks continue to mount. First, it was the airline industry, and now there's talk of the government helping the travel, hotel and insurance industries.

The problem is that none of these bailouts is necessary, says David Henderson, an associate professor of economics at the Naval Postgraduate School in Monterey, Calif., and a research fellow at the Hoover Institution. Henderson, who recently wrote a book in favor of less government and freer markets, says the private sector would have responded on its own, and he fears that all of these extraordinary measures will deplete the surplus and eventually lead to budgetary woes.

TSC: Your opinion that the \$15 billion federal airline bailout is wrong is a rather controversial position. You've said that consumers have voted with their pocketbooks by choosing not to fly, and that the federal government should not be spending our tax dollars to help the airlines. But isn't the airline industry such an important one and doesn't it impact many other industries such as commercial transport, hotels and leisure?

Henderson: Well, it does, but the point is that's the neat thing about a free market: It responds to people's wishes. And if people's wishes are for there to be fewer flights, then there ought to be fewer flights. The other thing is that the airline industry will survive, no matter whether there is a bailout or not, because the bailout essentially bails out the stockholders and the bondholders.

If there wasn't a bailout, you'd have bankruptcies, probably, and you would still have those assets in place. You'd still have the gates. You'd still have the planes. There might have to be a renegotiation of contracts, but that was something that was due anyway. That's why Southwest (LUV:NYSE - news - commentary) was doing so well, because they didn't have such expensive and inflexible labor contracts.

TSC: Wouldn't a rash of airline bankruptcies be disastrous for the economy and so many other ancillary industries dependent on the airlines?

Henderson: No. Why would it be disastrous? If [the airlines] go out of business, they're still in business. That's my point. Let's say they go bankrupt. If they go bankrupt, someone's going to want to buy the assets and use them to fly.

TSC: You believe so? You believe that we would still have the fleet that we have now?

Henderson: Oh, sure. We've had bankruptcies in the airline industry before. Those assets don't just disappear.

TSC: But what happens if there are further terrorist attacks in the skies and people simply decide that they don't want to fly over the next five, 10 years?

Henderson: That's unlikely. But let's say that's true. Why, then, should they be forced, then, to pay for something that they don't want? It's like challenging people who don't want buggy whips. Should we bail out buggy-whip manufacturers?

TSC: What's your opinion on the \$20 billion bailout for the City of New York? Are you opposed to that, too?

Henderson: What I liked about what happened a day or two after the Sept. 11 attack was that a whole lot of us in the rest of the country and in New York were sending money to people who were in really bad situations, and that's what is so great about this country -- the outpouring of generosity.

The opposite of that is the government saying, "We are going to decide, and we are going to be generous with other people's money. We are going to take taxpayers' money and decide how to spend it and who gets it." That removes any test of having money going to the places where the people giving it wanted it to go; it's just government officials making those decisions.

TSC: What about the insurance industry? Right now, with \$290 billion of capital in reinsurance reserves, the insurance industry is in good shape to cover the estimated \$100 billion cost of the Twin Towers disaster. Should the terrorist attacks continue, the insurers will then be exempt from having to make any payouts under an exclusionary war clause, and the government would then be responsible. Are you also opposed to this clause, which essentially provides protection for the insurance industry?

Henderson: Well, in fact, I think the government is already seriously talking about bailing them out. There was an interesting piece in *The New York Times* the other day where the author, in making the case for the bailout, was, without knowing it, actually making the case against the bailout. Let me explain.

What a lot of insurers say they are nervous about right now is insuring people and insuring buildings and so on, for future terrorist attacks, and if they are going to do it, they are going to do it at very high premiums. And so, the argument that was made in this article was that the government should provide some of this relief and provide that insurance at a subsidized rate so that people will stay located in or move to the riskier areas.

That makes no sense. Why has the government subsidized people to put them in harm's way? It's no different, in principle, from the government subsidizing flood insurance and as a result, keeping people living in flood plains. If the signal we are getting from the Sept. 11 attack is that we are in more danger in high-population density areas, it's a rational response on the part of people to try and avoid those high-density areas. To the extent that the government is subsidizing insurance, it is subsidizing people to stay in those high-risk areas, rather than to make the rational response.

TSC: But if the government wasn't doing these bailouts, wouldn't there be some wholesale panic going on among the general population and wouldn't that be terrible for our economy?

Henderson: I don't know why anyone would assume that there would be all this panic. It's a month later and I don't see panic, but rather people evaluating whether or not this situation is too risky. I don't get the panic part of it.

In fact, if the government was not doing these bailouts, the economy would be in better shape because every time the government spends on something, those are valuable resources -- material, manpower and so on -- that could be used somewhere else. They are using up valuable resources that could have been used up in other places by the original owners of those resources.

TSC: Over the past four weeks, President Bush and the Congress have committed hundreds of millions of dollars to various causes. How much more do you think the government can afford to spend?

Henderson: They have essentially just slopped up the [budget] surplus, and the surplus looks like it's close to being gone. If they continue on this path, they are either going to have to raise taxes or borrow more, and either way, the point is that they are taking resources that could have been used elsewhere. I'm not saying that every possible use the government would make [of the money] is bad. I'm saying that the argument that somehow it's great for government to be spending is bad. You don't treat the spending as a benefit; the spending is a cost. They are spending the surplus.

Finally, I will say that the failure of the government to protect us militarily is being used as an excuse for more government power. What we should instead be saying is, "How can we have better protection? Is the government a component of that? If so, how? Is it better for private people to have better protection, and if so, how?"

Those are the kinds of questions that we should be asking.