
Self-interest benefits everyone

The market meltdown wasn't caused by greed

Niels Veldhuis

THE common story now making the rounds is that Wall Street's "greed" is at the root of the financial crisis and that this "greed" needs to be reined in. Consider, for example, that US presidential candidate John McCain has promised to put an end to the "unbridled greed that [has] caused a crisis on Wall Street," while Barack Obama claims that the financial crisis is a "direct result of greed that has dominated Washington and Wall Street for years" (*Wall Street Journal*, 2008, Oct. 4; Langley, 2008, Oct. 14).

However, "greed" (or, less derisively and more accurately, "self-interest") is not the problem or the reason for the current crisis. Wall Street, Bay Street, Main Street, my street, and every other street in North America is built on individuals and businesses pursuing their own self-interest. Self-interested individuals and businesses are the backbone of our economy, vital to economic progress and society's well-being, and ought to be celebrated rather than demonized.

Let's start with the definition of greed, "a selfish and excessive desire for more of something than is needed," according to the Merriam-Webster dictionary. But who exactly should determine what is really "needed," and by what measure?

Do we all really "need" mobile phones and iPods? Is it "excessive" for a family to have two cars and a 2,000-square-foot house? Do we "need" to eat out as often as we do or buy the latest clothing fashions? What is "needed" is a subjective judgment and makes the definition of "greed" vacuous.

The reality is that "greed" is a contemptuous word that is purposely used to stir emotions and negatively smear the principle tenet of human behavior, self-interest. Simply put, self-interest is the human desire to improve our situation or the "concern for one's own advantage and well-being," according to Merriam-Webster.

The writings of Adam Smith, an eighteenth-century philosopher and the father of modern economics, provide great insights into the positive impact that individuals acting in their own self-interest can have on society. As Smith famously noted, "It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest" (Smith, 1981: 26–27).

The quality of food and high level of service we receive at our favorite restaurant is not the result of a kind act by its owners; rather, the owners are self-interested and wish to operate a profitable restaurant. They do not provide us with great food and service because they like or care about us; they do so to secure our business, money, and our continuing patronage.

The same holds true for Sam Walton, founder of Wal-Mart, Howard Schultz of Starbucks, Bill Gates of Microsoft, Steve Jobs of Apple, and any other successful entrepreneur. All acted in their own self-interest and provided us with great innovations, cheaper products, better services, and technological improvements. All became extremely wealthy by providing benefits to others, benefits that have vastly exceeded the private benefit gained by these entrepreneurs.

Economically free societies, in which individuals and businesses are free to act in their own self-interest and to engage in voluntary exchanges, enjoy substantially higher living standards. Increased economic freedom has been shown to increase per-capita incomes, economic growth rates, investment, life expectancy, civil liberties, and environmental performance, while reducing poverty.

Of course, individuals and businesses can also do harm if their self-interest is channeled improperly through deceit, corruption, force, fraud, or theft. That is precisely why it is critical to maintain sound institutions (a sound legal system, protection of private property, an independent and unbiased judiciary, etc.) to provide people and businesses with the right incentives and to hold them accountable for wrongdoing.

This brings us back to the current financial crisis. Of course, self-interested investors and banks played a part in the current crisis by lending money to unqualified applicants, issuing unsound mortgages, and trading in risky mortgage-backed assets. Home owners also acted in their own self-interest when taking on these loans. However, what is rarely mentioned is how government policy provided the incentives to do so.

The Federal Reserve kept interest rates historically low for too long, increasing the demand for mortgages and fueling the housing boom. In addition, government-backed mortgage giants Fannie Mae and Freddie Mac increased their purchases of mortgages issued to low-income earners, thereby funding billions of dollars in loans, many of which

were sub-prime. The Community Reinvestment Act also played a part as it further encouraged banks to make high-risk loans to low- and moderate-income families. In general, lending standards fell to accommodate a social policy objective: increasing home ownership among those who are least able to afford a home.

It wasn't greed that fueled the crisis; banks, borrowers, and investors simply acted rationally and in their own self-interest, following a set of rules created by poor government policy.

Americans have benefited tremendously from individuals and businesses pursuing their own self-interest. While it may not be popular to endorse self-interest, vilifying it is to condemn the economic system that has significantly improved our lives.

Nobel Prize-winning economist Milton Friedman (1979) said it best: "The world runs on individuals pursuing their separate interests ... the record of history is absolutely crystal clear: that there is no alternative way so far discovered of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system."

References

- Friedman, Milton (1979). *Milton Friedman – Greed*. Video. YouTube. <http://www.youtube.com/watch?v=RWSx1X8PV_A>.
- Langley, Monica (2008, October 14). Wall Street Donors Resent Being Blamed by McCain. *Wall Street Journal*.
- Merriam-Webster (2008). Greed. *Merriam-Webster Online Dictionary*. <<http://www.merriam-webster.com>>.
- Merriam-Webster (2008). Self-interest. *Merriam-Webster Online Dictionary*. <<http://www.merriam-webster.com>>.
- Smith, Adam (1981). *An Inquiry into the Nature and Causes of the Wealth of Nations* (Vol. 1). Liberty Fund.
- Wall Street Journal* (2008, October 4). Heard on the Street. *Wall Street Journal*. □