

# The Washington Times

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## Consequences of the Bailout

By Richard W. Rahn

Published December 14, 2008

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*VILNIUS, Lithuania.*

How much thought do you think Treasury Secretary Henry Paulson, Federal Reserve Chairman Ben Bernanke, and the members of the U.S. Congress gave to the damage that their economic policies would do to Lithuania and the new free-market democracies in Eastern Europe? The correct answer is probably little or none.

The Baltic nation of Lithuania has been a shining star. Freed from Soviet tyranny almost two decades ago, the Lithuanians have created a civil society that protects human rights, is a vibrant democracy, and has a strong free market economy with one of the highest growth rates in Europe - almost 9 percent last year. But now their economy is in danger because of the actions of government officials in Washington and, to a lesser extent, of those in the major capitals of Europe, and now even of some of their own leaders.

Vilnius, the capital of Lithuania, is studded with many new modern architectural gems. The "old town," parts of which stem from the Middle Ages, has gone through a glorious restoration and is filled with fine shops and restaurants. Unfortunately, construction, as in the United States, is now rapidly winding down as mortgages become increasingly difficult to obtain. As a small nation with only 3.3 million people, Lithuania depends heavily on foreign, particularly Scandinavian, banks for most of its retail and commercial banking services.

When interbank lending locks up among the major international banks, it has an immediate spillover effect on smaller banks throughout the world. The banks that service Lithuania are not eligible for U.S. Treasury and Fed bailouts, putting them at an immediate competitive disadvantage in a world of global financial flows.

The Lithuanians have just elected a new "conservative" government, which now faces an economic slowdown not of its own making. (Sounds familiar?) Unfortunately, the new leaders have proposed tax changes whose consequences are likely to make things worse. They understand a slower economy will result in less government revenue, but rather than take care of the problem by eliminating or reducing ineffective government programs, they are proposing increasing taxes on business.

Specifically, they have proposed increasing the corporate income tax rate, dividends and the tax from royalties from the current 15 percent to 20 percent. Other competitive countries have been reducing their corporate income tax rates, most recently the Bulgarians who now have a 10 percent flat-rate corporate tax. The Lithuanian government has also proposed a complicated increase in the tax on the smallest businesses, which almost certainly will lead to more tax evasion. The consequences of these tax increases will be slower economic growth, less international competitiveness, hence most likely less tax revenue rather than more.

Many policymakers and politicians in Washington seem to be incapable of thinking through the consequences of many of their bad ideas. When a "bailout" is given to one firm, all of its competitors are put at a disadvantage. For example, General Electric Capital, a unit of General Electric Corp., was given taxpayer funds "to make sure that the unit did not fail." But what are the consequences of such an action?

Because companies can move funds from one unit to another, an action to strengthen one unit of the company is to the advantage of all of the other units. GE's jet engine division competes with United Technologies' jet engine division (Pratt & Whitney), but now GE has a little additional competitive advantage.

GE also owns NBC, including MSNBC and NBC News. As former Reagan administration official and columnist Jim Pinkerton has correctly noted, MSNBC and NBC's news coverage has been strongly slanted toward the Democrats. Chris Matthews, well-known MSNBC commentator, who openly shills for the Democrats, has indicated he may run for the U.S. Senate. So here we have a case of the taxpayers giving a subsidy to a private company that gives a major TV forum to a partisan who uses it to further his own political agenda.

At the very minimum, GE should have been required to fully divest GE Capital in an exchange for the government funds to GE Capital. If News Corp., the owner of Fox News and the Wall Street Journal, had been given a "bailout" by the Treasury, the Democrats in Congress would have been outraged (and quite correctly so).

Two decades ago, the Lithuanian people had the courage to rise up and fight a government that had misspent their funds, mangled their economy, and trampled on their liberties. As a consequence of their victory, they became free and prosperous.

The U.S. government, though a long way from the old Soviet Union, is increasingly mangling the American economy, misspending taxpayer dollars, and often disregards personal liberties. This most often happens because political leaders do not and are not forced by many in the media and the body politic to think through and properly explain the likely consequences of their ideas and actions. This needed change is so obvious that it should be able to be accomplished without another revolution.

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