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PLEASE NOTE THAT THIS IS A VERBATIM TRANSCRIPT

MR. ALLISON: Good evening. It's really a pleasure to be here. I want to start by congratulating CEI on its very, very important work, and also congratulating many of you who I know are defenders of individual rights and free markets. Your work is incredibly important in the environment we're in today. I think we're in probably one of the most—I'm sure the most significant fight of our lifetime. On the surface, we're outnumbered about 1,000 to 1, and we seem to be losing. But the fight is not over. The fight is not over because we have the right ideas on our side.

I want to take a minute—

(Applause.)

I want to talk about the financial crisis—not because I enjoy talking about the financial crisis, but I think it's important that we have kind of a context of understanding. And I'm going to talk about the crisis both economically and—I think even more importantly—from a philosophical perspective.

If you look at the financial crisis and the challenges we have in our economy, no question: government policy was the primary drive of the crisis. We do not live in a free market in the United States. We live in a mixed economy. The mix varies a lot. Technology might be 20 percent government, 80 percent free. Financial services is probably 70 percent government, 30 percent free. And that highly regulated industry was the source of the beginning of our problems.

Because of government policies, we were able to create a huge bubble in residential real estate markets that worked through the capital markets and ultimately worked through the economic system. It is true that a number of major financial institutions made some very bad decisions, and that certainly impacted that crisis. But those decisions were secondary. If you look at what happened in our economy, we built—invested $800 billion too much in residential real estate. We built too many houses. We built houses in the wrong place. We built too big of houses. We should have been investing in technology, manufacturing capacity. We should have saved a lot more money.

How do you make an error of that magnitude? When you look at mistakes of that size, they almost always relate to government policy.

(Laughter, applause.)

In this case, there were three primary culprits: the Federal Reserve, the FDIC, and government housing policy, and specifically Freddie Mac and Fannie Mae—the giant government-sponsored enterprises. And then on top of the actions of those agencies, the Treasury, the Federal Reserve, Congress, and the president took an economic challenge and turned it unnecessarily into a disaster. And about everything that's been done since the crisis started will unfortunately reduce our standard of living in the long-term.

The beginning point—the context—is the Federal Reserve. It's interesting to me in just how many of the average persons do not really realize that the Federal Reserve is part of the government. They think it's somehow an independent agency. It's not. Basically, the monetary system in the United States was nationalized in 1913. The government owns the monetary system. If you're having trouble in the financial system, by definition it has to be primarily a government problem. It would be like saying the public schools—if you're having problems with the public schools it has got to be a government problem. They own the schools.

The Federal Reserve was theoretically created to reduce volatility in the financial system. What it has actually done is reduce short-term volatility, but it's created more dramatic changes at some points in the cycle. In the free market, there will be some ups and downs in the economy, because as human beings, we're not omniscient. But we wouldn't have the disastrous mistakes that only government policy can cause. The Fed itself admits it was one of the primary causes of the Great Depression. If you look at the current period of time, we haven't had an economic correction of any significance since 1990. During that period of time, the Fed was working hard to keep there from being any variation in the economy, and that pushed out the economic correction process.

The other thing about the Fed that people underestimate—the very existence of the Federal Reserve creates a huge amount of leverage and debt in our economic system. A state can borrow a lot of money based on its taxing power, but at some point it runs out of borrowing capacity. That's what's happened to California. However, the federal government not only has taxing power, but they can print money. And when you can print money, you can borrow a lot until you get into really serious trouble.

And then we've had some specific operating mistakes. Greenspan kept interest rates way too low in the early 2000s, which encouraged misinvestment in real estate. And then Bernanke raised interest rates—the fastest percentage increase in U.S. history—and created what's called an inverted yield curve. An inverted yield curve was a more profound impact on the financial system than people realize. Banks borrow short and lend long. When short-term rates get higher than long-term rates, which happened—Bernanke caused that—it killed margins in the banking business. It encouraged financial institutions to take a lot of risk.

By the way, you know, there are a lot of smart people in the Fed. However, smart people even with the best mathematical models cannot integrate all that's happening in a global economy with 6 billion people participating in that economy. Hayek talked about fatal conceit, and unfortunately that's one of the problems you have with the smart people in the Fed.

(Applause.)

The FDIC played a big role, too, in really eliminating market discipline. We saw that in our business. Lots of start-up banks in Atlanta where we operate. Many of those start-up banks have now failed or should have failed or are in the process. And of course, they could raise a little money, leverage it dramatically with FDIC insurance—money that people would never have put in those new banks if they weren't guaranteed by the government.

On a bigger scale, Golden West, Washington Mutual, Countrywide are large institutions that effectively failed, built nationwide franchises, opened branches everywhere, paid high rates on deposits. They would attract deposits out of financial institutions, and that's how they funded their lending activity. They were able to do high-risk lending that they couldn't have done in an open market.

The third and kind of the proximate factor was government housing policy. And this really goes back a long period of time, but it got accentuated in the recent past. For a long time, the government has tried to raise homeownership above what's called the natural market rate. They've done that through tax policy. But the most recent event that really undermined the current problems was in 1999. The Clinton administration announced a goal for Freddie Mac and Fannie Mae to have over half their loan portfolio in so-called "affordable housing," now subprime mortgages.

Interestingly enough, and there was actually an article in the *New York Times*—which is really interesting—there were a number of economists, including liberal economists, that said, "Well, you know, the affordable housing market is not that big. If Freddie Mac and Fannie Mae reach this goal, and it would take them about 10 years to do it, they would probably go broke and they could take the U.S. financial system with them."

Nine years later that happened. When Freddie Mac and Fannie Mae went broke, they owed $5 trillion, which now you owe. Congratulations.

(Laughter.)

Remember, a trillion is a thousand billion. They were leveraged 1,000 to 1. They had $1,000 of debt for every dollar in equity.

It was also—and this is really frustrating—it was a predictable disaster. I was on a committee, the Financial Services Roundtable, which is the 100 largest financial institutions in the United States, for nine years trying to do something about Freddie Mac and Fannie Mae. We ran the numbers, and they were going broke for certain. Mathematically, they were going broke. We talked to Congress over and over and over again, and they absolutely would not do anything about it—and for two interesting reasons. First was what I would call a religious belief in affordable housing. Now housing is a good thing, but encouraging people to buy houses they can't pay for is not a good thing—but there was a religious belief in affordable housing. And then secondly, Freddie Mac and Fannie Mae were huge contributors to both Democratic and Republican parties. And I think they were the largest single contributor to the Democratic Party. And the evil person, by the way, in this process was Barney Frank. He's a guy that—

(Laughter, applause, boos.)

He defended Freddie Mac up to the bitter end, the bitter end. (Laughs.)

It's interesting also how all these things work together, and I don't think people have thought a lot about this. If you look at how housing got in—financed by Freddie Mac and Fannie Mae, it goes back to the 1960s to Lyndon Johnson. Lyndon Johnson's program—

(Boos.)

—on—(laughs)—on the Vietnam War and on the Great Society had to be financed. The Federal Reserve initially financed it by incurring a huge amount of debts, and that sent a high—very high inflation rate. And then that inflation rate had to be brought under control by the Federal Reserve. And what happened was—in the old days, most people got their houses financed by savings and loans. And savings and loans had been in business for a long time. They'd been a very viable business. And if you wanted to buy a house, you had to put 20 percent down, they gave you a fixed-rate mortgage, and their loss rates were close to zero. The savings and loans made fixed-rate mortgages. They got killed by the rising interest rates that the Fed did because of the inflation created by Johnson. And then to help them, their regulator, the FSLIC, forced them to get into the commercial real estate lending business, which they had no expertise in. And then most of the savings and loans ended up failing in 1990.

Now, an interesting thing happened in that environment. Freddie Mac and Fannie Mae, these government sponsored-enterprises, took over the traditional home mortgage lending business. They drove everybody out of the market. And the way they did that—they were leveraged 1000 to 1—they had a government guarantee, they had the lowest cost to capital. We were in that business. We couldn't compete against the government. We were driven out of that business. That is how people like Golden West ended up in the negative amortization loan business. They couldn't figure out how to compete against the government, so they tried to find a niche. So a lot of the failures, the Countrywides, et cetera, were trying to compete against the government and ended up in the problems they were in.

A couple myths I'd like to talk about. One is the interesting myth that banking was deregulated—

(Laughter.)

—which is a real absurdity. I would argue that the banking regulatory environment during the bubble was the worst in my career, and I was in the business 40 years. But it was totally misregulated. A tremendous focus on two things. Sarbanes-Oxley, which was supposed to prevent fraud. Well, there had been no material fraud problems in the industry because in 1990, the industry already had a Sarbanes-Oxley. And secondly, the so-called PATRIOT Act, where we were supposed to catch terrorists. Do you know how many terrorists have been caught by the banking industry through the PATRIOT Act? None.

(Laughter, applause.)

You know how many are going to be caught? None. What are the odds of our tellers catching a terrorist? And by the way, if we caught one, do you think we might call anyway? Do we need a law to tell us about that? And then they got obsessed with mathematical modeling, and this played a big role. The Fed itself was obsessed with mathematical modeling. Many times we were told we need to have mathematical models like Citigroup and like Wachovia, that failed—right? (Laughs)—over and over again.

And this is interesting how this thing kind of went international. There was a theoretical international agreement called the Basel agreement, where banks were supposed to determine their capital based on mathematical formulas. Well, fortunately, it hadn't been fully implemented in the U.S., but it had been in Europe. And you may remember when this crisis started in Europe, for several weeks the Europeans were kind of laughing at us. And then all of a sudden, all of the banks in Europe crashed. And they all got taken over because under Basel, they had no capital.

One of the most interesting myths going right today is that the TARP money, et cetera, was given to banks to make loans. Not so, not so. What's actually happening at the operating level of the banks—even though the people at the top of these regulatory agencies are telling banks to make loans—at the operating level, it's very difficult to make loans because of local examiners who are lifetime government bureaucrats. The worst thing that can happen to them is something—their bank looks bad. So, they are forcing banks to tighten lending standers. Today, I guarantee you, BB&T did not make some loans that we would have made if the regulators weren't all over us. And we probably put some people out of business we didn't want to put out of business because the regulators were all over us. If you wanted to restore the economy, one of the easiest things to do would pull the regulators out of the healthy banks. We just passed the stress test, et cetera, et cetera, so we could go back in the lending business. But it's a myth that the regulators are encouraging banks to make more loans.

Another myth relates to the TARP program, and that's been an interesting and very, very offensive process. The first thing, the perception is that banks volunteered to go into the TARP program. Not so. We were forced into the program. And here was the theory: the Federal Reserve and the Treasury did not want it to look like they were bailing out unhealthy institutions. They had a list of unhealthy institutions, but if they only put money into those institutions, the market would know they were unhealthy. And also it was bad politics, so they forced the healthy institutions to participate in TARP. We were forced to participate in TARP. And, by the way, they made us sign a contract that said we had to do 100 things and they could change the contract at any time they wanted to. A great contract, right? Great contract.

And also, by the way, unhealthy institutions, TARP is a liability to the Treasury. But healthy institutions, it was a huge rip-off for us because we had to pay almost a 9 percent interest rate. We had to give them a bunch of options that are going to cost BB&T a loan $500 (million) or $600 million for something we didn't want in the first place. So, it's been a very interesting experience.

What are the cures? I think this group, really, in a certain sense knows that the fundamental cures are for restoring a market economy, letting poorly-run institutions fail, as they should—

(Applause.)

—not bailing everybody out, reducing government spending, reducing taxes on the productive, to quit redistributing wealth, reducing regulation, those kinds of phenomena. In terms of the financial system itself, if I had a magic wand, I would certainly privatize the system. I think as the Federal Reserve exists, the temptation to run up huge amounts of debt exists. Government has consistently debased the currency over long periods of time. I think we would probably select something like a gold standard because gold is hard to find, expensive to find, versus printing money.

(Applause.)

I'm not optimistic we will do that—(laughs). In light of not doing that, I do think there is a fairly simple approach that we could take. We could make banks have higher capital positions, so they would be at their own risk. Make it clear that if you weren't a bank, you couldn't have access to the Fed. You would not be bailed out. If General Electric got in financial trouble again—and by the way, they were one of the bailoutees in this process—they get to fail, and you could eliminate about 95 percent of the regulations in the industry. And that is a practical solution given that we probably won't move to a free-market environment.

I want to talk about, however, a deeper cause and a deeper effect, because I think it's just wrong we're fighting about economics. This is not a fight about economics, in my opinion. This is a fight about philosophy. If you look at the deeper cause of the financial crisis, it's really a combination of altruism and pragmatism. Altruism and pragmatism. Where did affordable housing come from? Everyone has a right to a house, right? Provided by who? Everybody has a right to medical care, provided by who? Of course, the right to medical care implies that I have the right to enslave a doctor or to enslave someone else to pay for that doctor. A total reversed concept of the American sense of rights. And if you have that kind of right, what do you do? You redistribute from the productive to the non-productive, and no one has a right to their own lives.

And then you compound that with pragmatism. And I think there's a necessary combination because altruism doesn't work. In the end, people do have to act in their self interest to some degree. And pragmatism says, "Let's do what works." Well, the unfortunate thing is a lot of things work in the short-term that are very destructive in the long-term. Negative amortization of mortgages worked for a fairly long period of time, and then became extremely destructive. Pragmatism encourages people to act in irrational matters.

People talk about greed on Wall Street. Greed is one of those nebulous terms. To me, what I think happened on Wall Street was irrational short-term thinking. That's really what it was about because a lot of those so-called "greedy" people ended up broke and lost their jobs, and weren't very effective with their greed. But what they were was they were irrational short-term thinkers. If you look at the Chrysler solution, it's got those two elements.

(Boos, laughter.)

Yeah. (Laughs.)

What are they doing? Altruism—let's save the autoworkers, right? Pragmatism—let's do what works. So, it destroys the rule of law. Who cares? In the long-term, we're all dead, right? A very destructive mindset. And that leads to an interesting thing. It leads to what I call the "free lunch mentality." You look at the last election. Neither candidate had any serious proposal to deal with Social Security and Medicare, despite their huge problems. And if they had, they couldn't have been elected. And that leads to a lack of personal responsibility, which is ultimately the death of democracy.

The Founding Fathers talked about the risk of the tyranny of the majority. And they really were talking primarily about the risk of not protecting individual rights—freedom of speech, freedom of religion. But they also recognized that when 51 percent of the people can vote a free lunch from the 49 percent, then it would become 60 percent want the free lunch and 40 percent, then 70 percent for free lunch and 30 percent, and then the 30 percent quit. And that unfortunately is the danger we face today. Because the problem is philosophical, the solution is philosophical.

The United States was founded on exactly the opposite of altruism and pragmatism. This was a country founded and based on fundamental principles: life, liberty, and the pursuit of happiness. Each individual's moral right is the pursuit of their personal happiness—the right to the product of their own labor. They don't have the right to what anybody else produces. And that, interestingly enough, demands that people take personal responsibility for their lives. It demands that they think. It demands that they have integrity, that they think about their long-term—what's necessary to make their life successful in the long-term because nobody is going to bail them out.

And interestingly enough—and this is an issue we don't talk enough about, in my opinion—what that demands is that individuals act in their rational long-term self-interest. People talk about—and economists talk about people being, quote, "selfish." My observation is that a lot of people aren't selfish. They aren't selfish in the sense that they do a lot of stupid things. They take drugs, as an example in that regard. And a lot of people don't act in their rational, long-term self interest. And I think we have to be defenders of rational, long-term self interest in the context of what I call the "trader principle."

The trader principle is the idea that we've got to create win-win relationships. In our business, we strongly believe that we need to help our clients achieve economic success and financial security, and we expect to make a profit doing it. But that has an authority command to how you act. We chose not to do these negative amortization mortgages where the mortgage get's bigger every month not because we had some great economic insight, not because we saw the crash in the real estate markets, but because one of the authority commands we have in our organization is we're never going to do anything that we believe is bad for our clients. Because in the long-term, doing bad things for your clients will come back to bite you. We believe in win-win relationships. If we do the right thing for our clients, we think that they'll do the right thing for us, and that's really, really our focus.

My favorite book by far and one of my reasons I'm doing speeches—now, this group, it's probably unnecessary—is to encourage people to read *Atlas Shrugged*.

(Cheers, applause.)

I actually believe getting people to read *Atlas Shrugged* is the most important thing we can do today, because here's a book written 50 years ago for the purpose of having what's happening today not happen. And yet, what's happening today is happening in that book—(laughs)—and I think people can see that in ways they couldn't have seen until now.

Where do we go from here? Here's the interesting thing. We have a very resilient economy in the United States. One of the challenges is we are probably going to have some kind of economic recovery, and unfortunately that's going to be interpreted as "Obama's policies worked." The reality is, however, what we've done is doom ourselves to a much lower real standard of living. And we're almost certainly—not certainly—but we're most likely to have a period of stagflation very similar to the 1970s: slow growth, high inflation, no fun. That's one reason that Reagan is seen as such a hero because he broke that very destructive cycle.

In the long-term, I think it's even more scary. It's even more scary, and I think it depends on us. If we continue to be altruistic, if we continue to be pragmatic, if we continue to go the direction we're going, the United States will go broke in probably 25 years or less. Now, broke may be hyperinflation, that may be the way it goes, but you can simply run the numbers. And to me, it is kind of eerie. It's analogous to what I saw looking at Freddie Mac and Fannie Mae. You know how these things start? They grow exponentially—25 years, boom, we go broke. The dilemma is we have huge deficits in Social Security, we have huge deficits in Medicare, and the numbers are much worse than they show you. We're running huge operating deficits. We've got a demographic problem with the Baby Boomers retiring. We've got a failed educational system in the United States. We've got some challenges.

Interestingly enough, the cure is the opposite. And it is curable, by the way. Just like Freddie Mac and Fannie Mae were fixable. But the cure is to return to the principles that got here in the first place: individual rights, free markets, limited government, less regulation, more economic freedom that spawns our innovation and creativity.

(Applause.)

I do have a fundamental sense—fundamental feeling of optimism in this sense: the United States has a really special sense of life. We're unique. And that sense of life is we're a very individualistic country. We're a very entrepreneurial country. And when I talk to a lot of people, they're confused about what's going on, but they're uneasy, because what's happening today is against the American sense of life and I think that's an important consideration.

(Applause.)

I think one of our challenges is to take on the issue from a philosophical perspective, and also to be—fundamentally—defenders of principle. And I think that's where we—some of our leadership has failed. At BB&T, we're very much a principle-driven organization. We have 10 core values. And underlying those values are what I believe are the three great virtues—the three great virtues: purpose, reason, and self-esteem—purpose, reason, and self-esteem.

As human beings, we are purpose-driven entities. We have to know where we're going to get there. Organizations are simply groups of human beings, and organizations need a sense of purpose. And for that purpose to work, it really has to have two interesting components. First, I believe practically everybody I've met wants to make the world a better place to live. I think that is a natural attribute of most human beings. Now, making the world a better place to live doesn't require that we go to Africa and feed hungry children. Businesses run properly make the world a better place to live. And when leaders of businesses forget that, bad things happen.

(Applause.)

But I also think that sense of purpose has to be rewarding to the individual. Each of us has the moral right to our own lives, and we need to recognize that right. And the purpose that inspires, I think, the people that work for our organization is they are doing the right things for the clients, and they're doing the right things for themselves. And we need to focus on the individual right to pursue your personal happiness in regards to your purpose. The means by which we accomplish our purpose is our capacity to think. We use the term "reason." Everything that's alive has a method of staying alive. A lion has claws to hunt with, a deer has speed to avoid the hunter, we have the capacity to think. And our capacity to think is literally our only means to survival, success, and happiness. And it's that context—there's only one, true natural resource—that is the human mind.

(Applause.)

And there are two pillars that make the human mind productive. The first pillar that people miss is freedom. Liberty makes the human mind productive. I see that in a regulatory environment. If you put a bunch of obstacles, people can't get the best solution. They can't think properly in a regulatory environment. Liberty makes human beings productive. Secondly is knowledge, and knowledge comes from education. That's why we have to have an effective education system, which is why we have to privatize our education system.

(Applause.)

A very interesting thing happens when people are clear about their purpose, and they use their thinking capacity to accomplish their purpose. They get to do something very important—they get to raise their self-esteem. And self-esteem is one of those really misunderstood and often inverted things in our society, but a couple of thoughts about self-esteem. Self-esteem comes from how you live your life. You earn self-esteem. Nobody gives you self-esteem, you can't give anybody self-esteem. You cannot give your children self-esteem. Live your life with integrity, raise your self-esteem.

Interestingly enough for most people—probably almost everybody in this room—most of your self-esteem comes from your work, and I use work in the broadest context. Raising children is very productive work. So, work is very important because it determines a lot of who you are, what your character is about. Something I say to all the employees of BB&T: it's really important to BB&T that you do your job well, it's far, far, 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, you'll never fool you. If you don't do your work the best you can possibly do it—given your level of skill, given your level of 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 is the flip is also true. Do your work the best you can possibly do it—given your level of skill, given your level of knowledge—and you will raise your self-esteem, and that's more important than when you get a promotion or how much money you make because it's about who you are. And it sets up the foundation for what I call the virtuous cycle: be clear about your purpose, use your thinking capacity to accomplish your purpose. That will raise your self-esteem, which will actually make you better able to accomplish your purpose in the long-term.

I think that we need to be the defenders of principled human action. And as such, we need to say that people have the right to their own lives and the right to the product of their own labor. You know, it’s an interesting thing that’s happening to us—and it kind of goes back to the sense of life issue—if you talk to—a lot of what’s going on now is we’re talking about security. Security is important in some sense to all of us, but the United States is not the land of security. People didn’t come to Jamestown to be secure.

(Laughter, applause.)

The United States is the land of opportunity, opportunity to succeed and, by the way, opportunity to fail. And we are the defenders of that sense of life, and that is very, very important work. Thank you for what you do.

(Cheers, applause.)

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