Hallowe'en

Taking Chances

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This article is the fifth in a year-long series about economics and holidays.

Hallowe'en is an unusual holiday, a blend of pagan and Christian customs. The ancient Celtic holiday of Sammain, celebrated on November 1st, when the wall between this world and the next was thinnest and spirits walked the earth, marked the start of winter in northern Europe. The last of the fields were harvested and the animals were brought in for either shelter or slaughter as the cold and dark season approached. Its Christian reincarnation is as All Saints' Day or All Hallows' Day when Christians remember those who have died in the faith. The night before, All Hallows' Eve or Hallowe'en, is still celebrated with an assortment of pagan customs, while the day itself is generally a major religious holiday for Catholics and many Protestants as well. (Hispanics and others also celebrate November 2nd, All Souls' Day, as the Day of the Dead.) The pagan customs of the evening before that still persist include trick or treat, ghosts and goblins, dressing up in costumes and bobbing for apples. Among the haunts on your doorstep on Hallowe'ens past have been such scary faces as Richard Nixon, Darth Vader, and Osama bin Laden, along with the standard and more traditional repertoire of ghosts, skeletons, vampires, devils, and witches. However you may celebrate, this holiday is a chance to let your fears, your ghosts and goblins, all hang out—and face up to them.

The economy at the end of the first decade of the 21st century has generated more than enough ghosts and vampires to meet the needs of the season. There are the ghosts of manufacturing jobs lost, of 401-Ks gone to the great hereafter, of scary banks, upside-down mortgages, and double digit unemployment rates. For those looking for more exotic threats, there is the predicted Mayan 2012 apocalypse, global warming, species extinction, and the prospect of Yellowstone as a supervolcano swallowing up most of the United States. Will all those actual and potential dirty tricks, where are the treats? Amidst all this horse manure, where is the pony?

So far there is no pony, but there is a lesson to be learned that may lead us to wiser and more cautious choices in the next decade. The important lesson of this first decade of the 21st century is about risk. It's about knowing what the risk is in investing in derivatives, real estate, or the stock market, and not believing everything the salesperson tells you. It's about the riskiness of depending on your employer for your health insurance and your retirement pension. It's about the limits to how much risk we can shift to the government in demanding that it provide deposit insurance, pension guarantees, health insurance, unemployment compensation, disaster relief, bailing out big firms like banks and auto producers, and preventing terrorist attacks. It's also about how we pay the bill for all that risk-shifting when it comes due, because we as a nation seem to be violently opposed to the kind of higher taxes other countries pay to have a public safety net.

When the government underwrites risk, it protects us from the consequences of our own negligence, carelessness, and ignorance. So we take greater risks than we would if we had to face the consequences ourselves. If the government is backing your firm up when you fail, or likely to bail you out, you take chances that you wouldn't if it weren't for the fallback of your rich Uncle Sam. Insurers call this problem moral hazard. If you have insurance, you are likely to be more careless than if you don't. If you have Social Security guaranteed by the government, you will probably save less for your own retirement. If your bank deposits are insured, you look for the highest rate of return rather than the safest bank.

There is some optimal level of government guarantee against risk. In the past, it has been accompanied by regulations to ensure that people don't take too many risks. Federally subsidized flood insurance is not available in some high risk areas where people might otherwise build and be flooded away multiple times, at high cost to the rest of us. Until three decades ago, banks were strictly regulated to limit their risk exposure by regulating their reserve obligations, their capital ratios, and the kinds of instruments in which they could invest. Alan Greenspan, the former Fed chair and longtime advocate of free financial markets, was heard nearly a year ago publicly admitting that he had believed that financial markets could be self-regulating, but he was wrong.

Much of the progress we have experienced as a nation has been the result of risk-takers, from the Pilgrims and pioneers to the inventors and entrepreneurs. But risk has a downside. For every success there are multiple failures. If we insure against failures, we create a demand for failure, and there are plenty of individuals and firms willing to supply to that demand. So choose your risks, your goblins and demons, with care. Your fellow taxpayers will be grateful for the treat.

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