U.S. Bailout Plan Threatens Basic Property Rights
By Peter D. Schiff

"Crony capitalism" is a term often applied to foreign nations where government interference circumvents market forces. The practice is widely associated with tin-pot dictators and second-rate economies. In such a system, support for the ruling regime is the best and only path to economic success. Who you know supersedes what you know and favoritism trumps the rule of law.

Unfortunately, recent events demonstrate that the phrase now more aptly describes our own country. On June 8th, the U.S. Supreme Court refused to hear an appeal from Chrysler LLC's secured creditors based on the government's argument that the needs of other stakeholders outweighed those of a few creditors. In this case, the Obama administration concluded the interests of the United Auto Workers outweighed the interests of the Indiana teachers and firemen whose pension fund sued to block the restructuring. Given the enormous financial support that the UAW poured into the Obama campaign, such partiality is hardly surprising.

When making their investment in Chrysler just a few months ago, the Indiana pension fund agreed to commit capital because of the specific assurances received from the company. In allowing this sham bankruptcy to be crammed through the courts, we have shredded the vital principal of the rule of law, and have become a nation of men, rather than one of the laws.

The risk that legal contracts can now be arbitrarily set aside will make investors think twice before committing capital to distressed corporations. Oftentimes, enforcing contracts imposes hardships. That's precisely why we have contracts.

Without absolute faith that deals will be honored, it will be extremely difficult for U.S. companies to borrow money. This will be particularly true for those companies already struggling with too much debt. Without the ability to issue secured debt, how will such companies access the necessary capital to turn around? If secured creditors cannot count on the courts to enforce their claims, they will not put their capital at risk. What good is being a secured creditor if courts can allow the assets securing your claim to be sold for the benefit of others?

Another problem with government imposing losses on secured Chrysler creditors is that in its bailouts of financial companies [such as Citigroup, Inc. (NYSE: C) and American International Group, Inc. (NYSE: AIG)], the government took steps to specifically pay back creditors even when those creditors should have been wiped out.

This inconsistency and lack of equal protection further undermines faith in our economy.

The message here is clear: Loan money to financial entities with friends in Washington and no matter how risky the loan, taxpayers will bail you out if it goes bad. However, loan money to a unionized manufacturer, even if prudently secured by real assets and you are as likely to get your money back as police have of finding Jimmy Hoffa's body.

As if this wasn't bad enough prior testimony from former Bank of America Corp. (NYSE: BAC) Chief Executive Officer Kenneth D. Lewis revealed a concerted effort on the part of U.S. Federal Reserve Chairman Ben S. Bernanke and former Treasury Secretary Henry M. "Hank" Paulson, Jr. to pressure Lewis into hiding relevant financial information regarding Merrill Lynch (NYSE: SKP) losses from B of A shareholders. Recently released emails make it clear that the government threatened to remove corporate leaders if they failed to go through with the merger and keep quiet about the losses.

Again, the justification for the interference seemed to be the "greater economic good" the merger would serve. The right of B of A shareholders to be informed that their company was about to buy a financial black hole was clearly considered to be an acceptable sacrifice.

More importantly, the fact that two of the highest ranking government officials can conspire to violate both securities laws and private property rights is abhorrent to everything America supposedly stands for. If they get away with it, which I believe they will, the precedent message will be chilling.

As a broker who specializes in foreign investments, I am always wary of political risk. I must consider how the threat of arbitrary government action could undermine the value of my investments. However, recent events show that political risk is now greater here than abroad, and U.S. assets, which have historically traded at premium valuations based on faith in our legal system, will soon trade at discounts to reflect this new threat. The fear of having contracts abrogated or property rights violated when doing so serves some contrived greater good will substantially raise our cost of capital and further reduce our competitiveness.

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