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# Liars, Liars – Pants on Fire

By Harold James

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When is it legitimate to lie? Can lying ever be virtuous? In the Machiavellian tradition, lying is sometimes justified by reference to the higher needs of political statecraft and sometimes by the claim that the state, as an embodiment of the public good, represents a higher level of morality. That tradition is once again in the spotlight, as the question of political untruth has recently resurfaced in many bitter disputes.

Did German Defense Minister Karl-Theodor zu Guttenberg have to tell the truth about the massive plagiarism that pervaded his doctoral thesis, or could a lie be justified because he was performing an important government job? Was the 2003 U.S.-led invasion of Iraq illegitimate because it was predicated on a falsehood about the existence of weapons of mass destruction?

The economic variant of Machiavellianism is as powerful as the claim that political untruth can be virtuous. Lying or hiding the truth in some circumstances can, it appears, make people better off. Deception might be a source of comfort. We might find ourselves warm and content in a cocoon of untruth.

One of the most famous examples concerns the Great Depression — an epoch that policymakers frequently drew upon in trying to come to terms with the post-2007 financial crisis. Many countries in the early 1930s had terrible bank runs, which inflicted immense and immediate damage, decimating employment by bringing down businesses that were fundamentally creditworthy.

There was one exception to the general story of Depression-era bank runs: Italy, where Mussolini's fascist government controlled the press, including the financial press. Although the major Italian banks were constructed on the same model as the German and Austrian banks whose collapse had ignited the global conflagration, and although the Italian banks were just as insolvent, the press never discussed these unpleasant problems. Financial journalism was soothing. There were no bank panics, and the depression was milder.

Since confidence plays a large part in financial crises, Mussolini's example immediately took hold. States could apparently almost magically create security and trust simply by imposing it. Hitler liked to say the ultimate cause of the Reichsmark's stability was the concentration camp.

Massaging the truth is eternally appealing to modern governments as well. They anticipate revenue to appear creditworthy. They reclassify foreign borrowing as domestic debt to look better in International Monetary Fund statistics.

For individual businesses, financial misrepresentation is illegal. But government dishonesty is not that different. Deceptions, when they are revealed, are deeply disturbing. Indeed, misrepresentation by governments — driven by the belief that political ingenuity can stabilize expectations — is actually at the root of many financial crises.

The Greek government's misstatement of its fiscal position, coupled with the realization that the European Commission had overlooked or tolerated the Greeks' accounting legerdemain, triggered the euro crisis in 2010. The revelation of deception makes it impossible to believe that governments are really enforcing rules adequately and fairly.

There is a powerful pragmatic argument against Machiavellianism, as well as a principled one. Given modern communications, a cover-up of the kind engineered by Mussolini in 1931 would most likely be unsustainable today. Moreover, any attempt to misrepresent requires further and more complex misrepresentations, which have serious consequences as subsequent decisions come to be based on erroneous assumptions.

To revert to the example of Depression-era Italy: The state holding-company edifice created to save the banks and maintain confidence proved to be an increasingly bureaucratic and costly burden on the Italian economy. The nearly indestructible behemoth outlasted Mussolini's regime and survived for 50 years.

Markets work by a process of continuous discovery of information. Choking off the flow of information leads to distortion, not confidence. And, as we are now witnessing in the Middle East, the same is true of political systems. Still, no economic crisis or political revolution is likely to change governments' inherent proclivity to think they can know better.

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