

## **Truth and Lies**

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This essay is about an important change in our culture that is likely to have important negative consequences economically, as well as politically. It is exemplified by the statement of an admirer about Bill Clinton when he was President. The admirer said that Clinton was an exceptionally good liar. A poor attempt to imitate Clinton can be seen almost daily when the current White House or the President discuss the economy. They seem to have no regard for economic truth or the likely consequences of their policies. I am constantly reminded of Hitler's chief propaganda minister who said that if a lie were told long enough and strong enough, eventually people would come to believe it. As a former professor who tried to teach people the truth about economic principles, I am outraged at the ease with which people holding the highest positions in our country lie so glibly about economic policies. That is particularly the case since I believe lies at the highest level undermine the willingness of everyone else to seek and tell the truth. That tendency has adverse consequences for the economy as well as for political realities.

### **The Nature of Truth**

#### **Scientific Approaches**

Most people assume that there is an underlying reality that represents a truthful view of the world. Scientists, like Albert Einstein, suggested that truthful effects could be discerned with repeated experiments that provided the same results. He said that the definition of insanity was to keep repeating the same process and expecting to obtain different results. He also said, in response to the development of Quantum Mechanics that, "God doesn't play dice" with the universe. He disliked the fact that Quantum uncertainties existed and felt that they could be resolved if theories of physics were completely developed.

As yet, there is no global theory that can integrate all known physical phenomena. However, that does not mean that no such explanation exists. Just as Newtonian physics had observational inconsistencies that Einstein resolved with his theories of relativity, future theories may be able to resolve apparent inconsistencies in current physical observations. Thus, scientists continue to seek new observations and theories that may help determine the true underlying forces and relationships that control our universe.

#### **Theological Approaches**

Most theologians believe that there is a higher power who holds dominion over the universe. Among other things, some point to the fact that there are natural physical laws that seem to exist that have been established by our creator and are "natural laws." Others say that the presence of a higher deity is obvious and that the faithful should believe in that deity so their prayers can be answered and they can have a better life and/or afterlife.

The Judeo-Christian religions believe in the "Ten Commandments." Among them is the commandment that "Thou shalt not bear false witness." In other words, it is a sin to lie. However, some "progressive" people who claim that the Second Amendment to the US Constitution only applies to the right of people in authorized Militias to own and bear arms, may also question this Commandment. Because people are sworn to tell the truth in legal proceedings, where they may be a witness, some "progressives" seemingly prefer to limit the commandment's requirements to formal legal situations.

#### **An Economic View**

Truthfulness is important to the proper functioning of an economy. If people are to engage in exchanges with others, they must be able to trust that others will keep their promises and that goods and promises exchanged will have the characteristics promised. There is an old adage, "Trust, but verify," that reflects the fact that not all economic promises can be accepted at face value. If they cannot, an expensive verification process may be needed before an exchange can be arranged or finalized. By increasing the cost of exchanges, fewer exchanges will appear to be feasible and fewer exchanges will occur. Thus, many of the economic benefits of specialization and exchange may be lost. In his writings on "Democracy in America," Alexis de Tocqueville noted that one reason that the US had thrived in its early years was because many people were religious and that they could trust one another when they entered into exchange agreements. I believe that since many religious people felt it was a sin to lie, exchanges

among such people were more easily facilitated, so more economic gains could be obtained from specialization and exchange, and the economy thrived as a result.

On a more practical sense, I used to advise my finance students that “reputation capital” was important. If others knew that they had a good reputation for keeping their word, other people would be more likely to do business with them, particularly in environments where speed was of the essence—as in deals made over the phone. In addition, in discussing credit analysis with my banking students, I emphasized that among the “3 C's” of credit analysis, probably “character” was the most important. If people were of poor character, others couldn't trust the reliability of the documents they presented to support their cash flow projections when applying for a loan or the value of the collateral they proposed to offer to secure a loan.

It used to be that accountants who validated financial reports could be held personally liable and sued if the accounts were later found fraudulent. Thus, they had strong incentives to provide reliable certifications for financial reports. Now, however, many accountants operate through limited liability organizations that shield their personal wealth from liability in the event of a lawsuit. In addition, companies issue and publish statements providing “adjusted earnings,” instead of earnings reports based upon Generally Accepted Accounting Principles (GAAP) accounting. A cynic, like myself, may call those reports “earnings without the bad stuff.” It means that people who invest need to spend more time and effort ferreting out what true GAAP earnings are and what true cash flows are for the business in question. This makes investing more difficult and has led to less competition in investor viewpoints as people rely on others to make their investment decisions for them. Sadly, many of the professional investors charge high fees and engage in “groupthink” that can cause stocks to be valued incorrectly.

Because our top political leaders have lied repeatedly about the economy and their lies have become more apparent, more people in the economy have been emboldened to lie also-- if they perceive that their lies may help them profit personally without serious consequences. As a result, the cost of verifying the accuracy of peoples' economic statements and financial documents and promises has grown in recent years. As these verification costs have grown, economic and financial frictions have grown as well. This will ultimately result in declining economic efficiency as more and more economic resources will need to be devoted to “verifying” others statements. Thus, costs of transacting will grow and be centralized, at higher costs in terms of competitive efficiencies. As a result, fewer economic resources will be available to provide personally valuable goods and services to consumers and economic welfare and growth will be diminished relative to what it otherwise could have been.

### **A Personal Note**

I personally believe that it is wrong to lie, not just because prevalent lying will eventually have adverse economic, sociological, and theological consequences, but also because it will cause energy and resources to be wasted irretrievably. The second law of thermodynamics says that no perpetual motion machine is possible since it will take more energy to restore a system to its original state than can be achieved from letting it change its state (like water boiling in a steam engine or a moving pendulum). Thus, when a lie occurs, not only may people make bad decisions based upon the lie, but it will be more costly to rectify the lie and restore the original state of the world as if the lie had not occurred. Consequently, lies result in a waste of energy even if they are ultimately found out and corrected. The universe may only have a finite amount of energy and energy is required to maintain and support our civilization. Thus, the waste of energy caused by a lie may hasten the movement of our universe toward a time when its energy resources become insufficient to prevent disorganized “chaos” from overcoming our civilization.