A Republic of Speculators

by H.A. Scott Trask

Bad Money: Reckless Finance, Failed Politics, and the Global Crisis of American Capitalism
by Kevin Phillips
New York: Viking Penguin;
239 pp., $25.95

The long-suffering and largely ignored paleoconservatives might be forgiven for taking some satisfaction in the recent bursting of so many bubbles of avarice and pride, the sudden exposure of so many highly leveraged speculations in stupidity. Let us recount some of the failed millennial assertions by the ruling party: that history has come to an end; that this will be a second American Century; that U.S. military power is omnipotent and redemptive; that nationalism and religion have lost all value in the global marketplace; that nature has been remade to serve our pleasure; that technology has abolished the laws of scarcity; that the business cycle has been broken and stretched into an ascending line to utopia; that we can borrow and spend our way to imperial munificence and exurban bliss.

Hence the shock when, in a little less than a year, Americans have seen the dollar plunge, inflation soar, the housing market collapse, the price of gas explode. With their wages stagnating, their savings near zero, credit cards maxed out, their government in deficit and overextended abroad, Americans are panicking, and the mood is understandable. Public-sector debt (state and federal) stands at $11 trillion. That's less than one third of private-sector debt, which is a staggering $37 trillion, and that does not count unfunded federal liabilities (Social Security, Medicare, pensions). The ratio of credit-market debt to GDP is higher than it was at the height of the Great Depression. In 1929, this ratio was 176 percent. In 1933, after FDR devalued the dollar, it rose to 287 percent. In 2006, the ratio was 335 percent.

And there's no end in sight. The United States now imports 72 percent of her petroleum, and both the federal government and the consumer are dependent on annual infusions of foreign capital (to fund the wars of the former, the credit cards and home mortgages of the latter). The U.S. current-account deficit for 2007 was $857 billion, nearly double what it was in 2001. U.S. manufacturing has fallen to 12 percent of GDP, while financial services have climbed to 21 percent.

Kevin Phillips understands that President Richard M. Nixon staged the necessary first act when he severed the dollar's last link with gold in 1971. But in *Bad Money*, he points to the late 1980's, with its lethal combination of liquidity, deregulation, and financial bailouts, "as the launching pad of a decisive financial sector takeover of the U.S. economy." The clearest evidence was the setting up of the President's Working Group on Financial Markets (the Plunge Protection Team) in 1988. Its members included the chairman of the Federal Reserve and the secretary of the treasury. Their task was to intervene whenever panic gripped the stock, bond, or money markets and to restore stability or (what is the same thing) preserve the value of financial assets. Their techniques included emergency loans (often at below-market interest rates), cash infusions, the lowering of interest rates, pressuring healthy firms or even foreign investors to bail out ailing firms, even buying on the futures market to prop up falling stocks. From 1982 to 2002, the Federal Reserve and the U.S. Treasury, together or separately, intervened 11 times to rescue financial firms from the consequences of their own recklessness and greed. In March the Fed provided $30 billion to facilitate the buyout of the bankrupt investment firm Bear Stearns by the behemoth JP-Morgan Chase. More recently, the government nationalized the federal mortgage lenders Fannie Mae and Freddie Mac, and bailed out insurance conglomerate AIG, before authorizing an $850-billion bailout plan that would allow Washington to purchase distressed mortgage-backed securities. For privileged and protected speculators, the profits are private, but the risk is public. Thus, at the very time (the 1980's) when our so-called elite was scorning an industrial policy as a violation of the sacred laws of the all-seeing market, it was quietly adopting a government-sponsored financial policy.

It was the wrong road, but it was only one of many; 1986 was the year of the Reagan immigration amnesty, which falsely promised enhanced enforcement while flashing the green light to the world: There will be no deportations. After a few years of ineffectual hand-wringing about America's "twin deficits" in trade and government spending, the powers that be finally decided after the 1992 election that "deficits don't matter" in the new global economy. The debate about national decline begun by Paul Kennedy in his *Rise and Fall of the Great Powers* (1987) was silenced following the triumph of the Persian Gulf War. When the Soviet Union dissolved into its constituent republics, some wondered whether it was time to bring the troops home. Instead, our political class decided that the world had become more dangerous than ever and that the vacuum created by the fall of communism had to be filled with American bases and American pride. It was the "unipolar moment," and we were "the indispensable nation."

Kevin Phillips' last book to influence policy or politics was his first one, *The Emerging Republican Majority* (1969), which taught the Republicans how to win national elections. Since the onset of the Bush regime, he has tried to warn people how the Bushies have been ruining the country. In *The Politics of Rich and Poor* (1990), Phillips noted "the Republican Party's historical role" of "tilt[ing] power, policy, wealth, and income toward the richest portions of the population." He pulled back the curtain of free-market rhetoric to reveal what was really going on: the upward redistribution of wealth by government policy. The techniques are as old as Alexander Hamilton: debt management, currency manipulation, discriminatory taxation. "Laissez-faire is a pretense," he wrote in *Wealth and*

Poverty: A Political History of the American Rich (2002). "[G]overnment power and preferment have been used by the rich, not shunned."

In *Boiling Point* (1993), he wrote of the betrayal of the American middle class by their political leaders, but also of the dangers of "financialization," "the cumulating influence of finance, government debt, unearned income, rentiers, overseas investment, domestic economic polarization, and social stratification," all signals of a "broad national decline."

In *Arrogant Capital* (1994), he wrote of the financial corruption of the republic. While ordinary Americans were on their own in the "new service economy," big investors, speculators, and money managers who got into trouble could count on being rescued by the government through a policy of "financial mercantilism." The 1989-92 bailout of the bankrupt savings-and-loan industry "was the biggest in America's history," costing the taxpayers $250 billion. It saved the speculative economy.

In *American Theocracy* (2006), Phillips warned of the perils posed by radical religion, oil dependency, and borrowed money and predicted a coming "credit and financial collapse" in which "stock and home prices would . . . sink together." Two policies adopted after the stock-market collapse and the 2000 recession made it inevitable: Bush's tax cuts and spending increases, and Greenspan's 13 successive interest-rate cuts. The effect "was to inflate a new real estate and credit bubble" even bigger than the NASDAQ one. *Bad Money* is all about the arrival of the long-delayed day of reckoning, the beginning of the "deleveraging of a giant two-decade build-up of debt and liquidity."

Phillips wrongly identifies Joseph Schumpeter as a member of the Austrian School of economics, while never mentioning Ludwig von Mises or F.A. Hayek, whose theory of the business cycle has been vindicated yet again. I can understand why the paper pushers and the inflationists ignore these brilliant diagnosticians (because their prescription, re-anchoring the dollar to precious metals, is anathema), but why has Phillips not bothered to get this right?

The magicians at the Fed and the Treasury may have prolonged an inflationary and speculative economy, but they cannot perpetuate it. They cannot conjure wealth out of paper. Nor can an empire continue to police the world on borrowed money, or a people trade "services" and debt for real goods. Real wealth consists in substantial capital (good houses, fertile land, workshops, factories, universities, libraries, works of art). The idea that "financialization" could replace manufacturing as the material foundation of national power and wealth is, as Phillips points out, an error previously made by Spain, Holland, and Britain. In our country this error goes back to Hamilton, who believed that government bonds were capital, when they were only government promises to extract capital from the productive economy. (So it is with finance in general. It is parasitic, not productive.) The fallacy has not been corrected. Instead, it has been extended to the magical market in financial derivatives (mortgage-backed securities, collateralized debt obligations, credit default swaps, *etc.*), which are nothing but glorified IOUs.

Americans are going to learn the hard way that they cannot continue to scorn the law of limitation. There is a limit to how much debt even a great empire can carry, as there is a limit to how much population and diversity a country can have before it collapses from within. Niall Ferguson observed in 2006 that the United States had become an "impire" which "expands by importing, not exporting people," "to the tune of roughly 1.5 million newcomers a year." That cannot continue indefinitely. Nor can the debt and the inflation, the self-indulgence and the boastful pride, or the arrogant denial. If the Panic of 2007-08 changes any of that, it will prove to have been a most fortunate occurrence.

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Man on Holiday

by Fr. Michael P. Orsi

Darwin Day in America: How Our Politics and Culture Have Been Dehumanized in the Name of Science
by John G. West
Wilmington, DE: ISI Books;
375 pp., $28.00

John G. West is a senior fellow at the Discovery Institute, a nonpartisan public-policy think tank that conducts research on technology, science and culture, economics, and foreign affairs. The Institute's Center for Science and Culture is notable for challenging various aspects of evolutionary theory—maintaining, for instance, that evolutionary biology has failed to answer many salient questions.

West's primary thesis in *Darwin Day in America* is that our culture and politics have been dehumanized by a scientific materialism (or reductionism) that sees man merely as the sum of his parts, and that this dogma has taken over the educational system in the United States. He notes that anyone who questions Darwinian evolution—the central idea in this reductionist mind-set—is denounced by academia as a biblical fundamentalist or creationist, and therefore as antiscience.

Two high-profile examples serve to make his point. The first is the 1997 Washington State case in which harassment and punitive measures were applied to Burlington-Edison High School biology teacher Roger De Hart. His crime was that he had asked his students to prepare arguments for either evolution or Intelligent Design. The second is the 2004 Pennsylvania case in which the Dover School Board required that students be informed of Intelligent Design as a possible alternative to Darwinism. In a suit alleging that this constituted the promotion of religion, the judge issued a scathing attack on ID and its proponents. His decision, as demonstrated by West, was copied directly from the handbook of