

KEEPING THE INSULATION FROM COMING UNDONE:

American debt, Wall Street and looming realities

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Just over a month ago, American Special Forces entered Pakistani territory in secret, then entered a secure compound long inhabited by Osama bin Laden, his family and a few close aides, and killed the famous leader of al-Qaeda. Almost incredibly, the whole thing was watched live on video cam from the White House. This was itself a remarkable achievement in its own grim way; a kind of signature effect in our time. The enemy was not just tracked down on the other side of the world at the behest of the President of the United States; the actual ambush and killing of the arch enemy was watched live by the President of the United States and his closest advisers. It was a dramatic moment and, by any measure, a striking dénouement to the assault on the United States in 2001 and the boast of Osama bin Laden that he would bring the United States to its knees.

This evening, however, what I want to discuss with you are the ways in which the United States has almost been brought to its knees by its own follies, even as it fended off the Islamist assault and finally destroyed the Muslim fanatic who had boasted that he would inflict lethal blows on the Great Satan from his hideout on the far side of the world. I shall argue that the most damaging blows to the prestige, wealth and geopolitical supremacy of the United States over the past twenty years have not come from external enemies, but from its own errors and extravagances, both in domestic and in foreign policy. I shall argue that this should concern all of us, since the pre-eminence of the United States over the past seventy years – and it is still not quite seventy years since the Japanese attack on Pearl Harbor – has, all things considered, been a boon to the world. Should the Great Republic go into sharp and even irreversible decline, the consequences for all of us could be far more serious than a great many people appreciate.

Let me begin by briefly recapping on the significance of Osama bin Laden and his fate. The assault on America on 11 September 2011 came, proverbially, out of a blue sky for almost everyone. As the noted Jewish American commentator Leon Wieseltier expressed it “The American insulation had come undone. It was one of those moments—our strong and lucky history has spared us many such grim epiphanies—when you recognize again how much your country, how much this country, matters.” *The American insulation had come undone*. Remember that

phrase. I will come back to it. The celebrations that immediately followed bin Laden's demise should be seen in this light. As Wieseltier pointed out in the pages of *The New Republic*, a certain wittiness at the time showed the spirit of the republic: "Osama bin gotten" and "Donald Trump wants to see Osama bin Laden's death certificate" are two of the more notable quips.

These celebrations were surely understandable. Those who unctuously intoned that the taking of any human life is always to be regretted and that Osama bin Laden should have been arrested and put on trial were, I suggest, forgetting themselves. I am reminded of the exchange between Victor Komarovsky and Yuri Zhivago concerning the suicide of Pasha Antipov (Strelnikov), in David Lean's famous film of *Doctor Zhivago*: where Komarovsky declares harshly to the shocked Zhivago, "Spare me your expressions of regret. He was a murderous neurotic and of no loss to anyone." Osama bin Laden was every bit as murderous as Strelnikov and he did not commit suicide, like Strelnikov, in remorse for having sacrificed love for the empty cause of violent revolution. Osama demonstrably died planning multiple further atrocities. He was killed on the field of battle and we should not mourn his passing.

Michael Scheuer's study of Osama bin Laden, released just before the master terrorist was cornered and killed, showed him great respect, as an enemy who understood America better than the masters of war in the United States understood him. So might a Roman analyst have written of Hannibal's relentless campaign against the Roman republic. Those of you who know your ancient history will recall that Hannibal, also, was defeated and pursued to the East, to the very courts of Mithridates of Pontus, where he was continuing to plot assaults on Rome. Rather than submit to capture or betrayal, Hannibal took poison and died, while Osama bin Laden reached for a gun, it seems, and was shot. In both cases, a mortal enemy was brought to heel and the celebration as well as relief in the republic was palpable. The Roman antecedent suggests, however, that our attention should be focused less on the death of an enemy long beaten back and at bay, than on the condition of the republic itself.

After the defeat of Hannibal, Rome apparently went from strength to strength, as it conquered the entire Mediterranean basin. The republic, however, suffered from ever more acute internal corruption, constitutional crisis and social disorder, which culminated, after a series of civil wars, in its downfall and the rise of the empire. Right now, in the wake of the killing of Osama bin Laden, who never did achieve the status of a Hannibal, for all his dark ambitions, the internal condition and global standing of the United States cry out for careful examination and serious reform. For economically, socially, morally, politically and geopolitically, the United States is far from being in mint condition and I use that expression quite deliberately in all the

circumstances. So much is this so that, were I a lecturer in ancient history at a good university – or a liberal arts college of the kind this country conspicuously lacks – I would be guiding my students this year through a close reading of Livy's *Rome and the Mediterranean* and Ronald Syme's *The Roman Revolution*.

The Great Republic has been gravely weakened over the past decade, not by terrorism, but by debacles almost wholly of its own making and the disgraceful debacle of 2008, the effects of which are still being felt, came perilously close to bringing its insulation undone in a way Osama bin Laden had never been able to do. The US operation to kill bin Laden was code-named Operation Geronimo, which shows how much confusion there is concerning the kind of danger he posed. This designation was vehemently protested by the Apache leader's great grandson Harlyn Geronimo on 5 May this year as a grave insult to Geronimo. Perhaps, however, the analogy is of some use in that Geronimo had long since been on the run when finally cornered and captured by the US cavalry and had never posed an existential threat to the United States. Over several decades, he had killed hundreds of Mexicans, whom he despised, but relatively few citizens of the United States, though his raids spanned New Mexico, Arizona and western Texas. Osama had certainly done more direct harm and aspired to do far more, but so long as the United States had its house in order there was simply no way he could have dealt it an existential blow.

We need to be clear about this. A United States in sound economic order and sound political order would always have been able to absorb any conceivable blow that al Qaeda could have dealt it. The United States, however, is not in sound economic or political order. It has delivered a series of mighty blows to itself, all on its own, and they are far from having been fully absorbed as we gather here this evening. The image of the World Trade Center twin towers crumbling as the sun shone over New York was unforgettably dramatic, but the realities of the US economy being shaken to its very foundations by fiscal mismanagement, corporate corruption and the sheer stupidity of Wall Street bond traders over the past decade should actually disturb us a great deal more. The increasingly polarized and demagogical character of politics in the United States; the dominance of bully pulpit propaganda and irresponsible rhetoric over serious and principled debate are profoundly troubling. This is all the more so because of the similar malaise in both the European Union and Japan. It is less than a decade since the publication in New York of Michael Mandelbaum's book *The Ideas That Conquered the World: Peace, Democracy and Free Markets in the Twenty First Century*. Yet we have seen in the past few years that

all three could yet suffer grave setbacks unless the underlying vitality of the liberal democracies and above all of the United States can be restored.

Much of the blame for this tends, understandably, to get laid at the door of George W. Bush and Dick Cheney. They get pilloried for cutting taxes while launching two expensive foreign wars, for politicizing and bungling intelligence assessments with regard to Iraq, for being somehow complicit in the Enron scandal and the moral taint it spread over the supposedly booming economy of the United States; for abrasive American unilateralism and for failing to head off the economic debacle we all know as the GFC. They deserve much of this criticism. But the problems run deeper and go back further than the Bush administration. The relentless decline in financial prudence on Wall Street also goes back many years before Bush and cannot be laid at the door of the Republican Party alone. The long reign of Alan Greenspan at the Federal Reserve did America harm and neither Greenspan nor any of his circle has been adequately held to account. Indeed, one of the notable features of the economic debate since 2008 has been the tendency of too many Republicans and libertarians to deny that corporate corruption, recklessness and inadequate regulatory oversight contributed anything to the catastrophic debacle of 2008.

There has been something of an avalanche of books about the global financial crisis and the corruption and near self-destruction of Wall Street, but none, I think, more readable, more illuminating or more devastating than Michael Lewis's *The Big Short*. Some of you will be acquainted with the little book that made Lewis's name in 1989, *Liar's Poker*, about his strange experience working at Salomon Brothers in the mid-1980s. As a young man not yet thirty years old, Lewis wrote in 1989: "I set out to write this book only because I thought it would be better to tell the story than to go on living the story." Twenty years later, incredulous at what had occurred in the intervening years, in which he had become a writer celebrated for his intelligence, dry wit and unpretentious style, he wrote about what he called "the doomsday machine" that had taken the American economy and democratic governance to the verge of breakdown. I want to share a little of this with you, because as much as any more detailed analysis, for which, in any case, I do not have the time or space this evening, the story that he tells takes us to the heart of what I believe should most concern us far more than the life or death of one Arabian brigand and jihadist.

Lewis titled the Prologue to his 2010 book, *The Big Short*, 'Poltergeist'. These were his opening remarks:

The willingness of a Wall Street investment bank to pay me hundreds of thousands of dollars to dispense investment advice to grown-ups remains a mystery to me to this day. I was twenty four years old, with no experience of, or particular interest in, guessing which stocks and bonds would rise and which would fall. Wall Street's essential function was to allocate capital: to decide who should get it and who should not. Believe me when I tell you that I hadn't the first clue...

He wrote *Liar's Poker*, he went on to say, because he thought that “unless some insider got all of this down on paper, no future human would believe that it had happened.” He added: “...what I never imagined is that a future reader might look back on any of this, or on my own peculiar experience, and say, ‘How quaint. How innocent.’” And when you read his or any one of a number of the recent books on the debauching and near bankrupting of America, you understand without any difficulty just why he wrote that.

Among the very many details on which it is important to reflect from this whole wretched and morally disgraceful episode, let me single out just one anecdote related by Lewis, which I think is emblematic of the pervasive problem facing the Western democracies in our time. It concerns a huge gathering of bond traders and their hangers on in Las Vegas in January 2007, which was also attended by a small number of sceptics and mavericks seeking to calibrate their independent judgments that the mortgage and bond markets were locked in a death spiral that could bring the American insulation undone in a spectacular way. Lewis relates that on the first morning of the conference, a crowd of thousands flowed “out of the casino into the vast main ballroom to attend the opening ceremony.” The moderator of this opening ceremony, Lewis was informed, “appeared to be drunk, or at least unhinged”.

His name was John Devaney and he ran a hedge fund that invested in sub-prime mortgage bonds, United Capital Markets. For a decade now, Devaney had sponsored this conference – called ASF or the American Securitization Forum, in part because it sounded more dignified than the Association for Subprime Lending. To the extent that the market for subprime mortgage bonds had moral leaders, John Devaney was one. He was also an enthusiastic displayer of his own wealth. He owned a Renoir, a Gulfstream, a helicopter, plus, of course, a yacht. This year he'd paid some huge sum to fly in Jay Leno to serve as the entertainment.

Now, looking as though he had just strolled in from a night on the town without pausing to take a nap, John Devaney delivered what was clearly an extemporaneous rant about the state of the subprime market. “It was incredible,” said Charlie [Ledley, Lewis's informant]. “Stream of consciousness. He went on about how the ratings agencies were whores. How the securities were worthless. How they all knew it. He

gave words to stuff we were just suspecting. It was like he was talking out of school. When he was finished there was complete silence. No one specifically attempted a defense. They just talked around him. It was like everyone pretended he hadn't said it..."

Ponder that scene and that coda to it. That is the world we all live in, not merely with regard to the specific financial crisis in the American housing and bond market, but more generally with regard to the challenges we face as a species. But it is stunning even if we confine our reflections to its implications for the American economy. The overwhelming impression one gets from the accounts of the financial crisis provided by Lewis and others – such as Roger Lowenstein or William Cohan – is that the mortgage industry, the bond trading houses and the investment banks, the US Federal Reserve, the ratings agencies, the US Treasury and virtually every other theoretically accountable body in the Great Republic was either unable or unwilling to see the crisis coming or do anything to avert it. Nor were any of them very willing in its wake to accept responsibility for it. The collapse, in 1998, of Long Term Capital Management, headed by the former head of Salomon Brothers bond trading, John Meriwether, should have prompted much closer regulatory oversight of financial markets. It didn't. In fact, over the following twelve months, Alan Greenspan, Larry Summers, Robert Rubin and other leading figures in US financial regulation, aggressively deflected the attempts by Brooksley Born, chair of the Commodity Futures Trading Commission, to generate a debate about whether derivative instruments should be allowed to function in a regulatory vacuum.

The dotcom bubble burst a year or so later, demonstrating definitively that Greenspan and Bernanke and others had been fundamentally in error in dismissing both the desirability of deflating bubbles and even the reality of bubbles as such. The Enron scandal demonstrated that fundamental corruption of fiduciary and prudential oversight had occurred in the American corporate world. Yet nothing was done which might have prevented that corruption from totally compromising the three premier ratings agencies in the ensuing few years in their dealings with the bond traders and investment banks. At the same time, the Bush administration was rapidly turning the surpluses and apparent promise of the Clinton years into yawning deficits on the grounds that, in Dick Cheney's notorious words, "Reagan showed that debt doesn't matter." This fiscally reckless attitude prompted the resignation of Treasury Secretary Paul O'Neill, after the first two years of the younger Bush's presidency. O'Neill resigned because he believed that the Bush/Cheney White House was being fundamentally and incorrigibly irresponsible in its macro-economic policy. It had undertaken sweeping tax cuts while launching two expensive wars

and was secretive about its operations to an extent that O'Neill believed was wholly counter-productive.

And even as the Bush administration cut taxes, launched wars and neglected the basic regulatory institutions of the Great Republic, the mortgage market was spiralling out of control and the Wall Street bond traders were making a killing by ever more cynical, fraudulent, deluded and unsustainable means. The single most disturbing feature of all this, arguably, was that the top tier managers of the biggest risk and capital management institutions in the most sophisticated capitalist country in history failed to understand where all this was heading until it was too late – and then ran to the Federal government looking for public bailouts, when morally speaking they should have been hung out to swing in the wind. As Lewis mordantly observed, it was the call by Meredith Whitney, an analyst at the small and independent firm of Oppenheimer and Co., in October 2007, that Citigroup's management were not so much corrupt, as stupid that opened up the can of worms. They didn't know how to manage their own capital, to say nothing of the nation's or the world's. And they were far from being alone, as it turned out – whether in America or Europe. Not for the first time, but surely in a more than ever infuriating way, the world of democratic capitalism has been very badly served by its supposedly leading lights.

But it is just as important to emphasize that the public debt piled up in the name of social security, Medicare and Medicaid in the United States and the literally insane leveraging indulged in by Fannie Mae and Freddie Mac in the years leading up to the 2008 crisis have also been and remain very important maladies in the American economy. It would be well to remember that the Roman republic was torn apart not by a war between corrupt plutocrats and virtuous, republican plebeians, but in a series of civil wars between those who clung to the old order in the hope that it could somehow be salvaged and those who sought to replace it with a form of monarchy because they had lost belief in the old republican institutions. There were at least as many demagogues on the revolutionary side as on the patrician side and the outcome was a tyranny, even if it was also a more stable imperial government. The Republican Party right now often looks cranky and irrational; but the Democratic Party at times looks ideologically self-indulgent and delusional. And none of this is good news for those of us who have long regarded the American Republic, with all its flaws, as the chief guarantor of global security and prosperity.

The alarming decline in the quality of American public education for decades now is another sign of decay. And contrary to the ideological rallying cries of Democrats or their socialist partisans elsewhere, these problems have not, let me repeat *not*, been caused by lack of government funding. Spending on education, as on health care in the United States has been

trending relentlessly up since the Great Society legislation passed by Lyndon Johnson in 1965 and now totals about 7% of GDP in each case – substantially more than is spent on defence. As Christopher Chantrill put it in an analysis of US Government spending in the 20th century:

Nobody, in 1900, speculating on the future of government, could have imagined the astonishing growth and scope of government in the 20th century. Nor would they have imagined that, for many people, this gigantic government would seem the very essence of efficiency, compassion, and modernity. But the reason that government has got so big is not, as many claim, the weight of armaments and wars. Instead the money goes for health care, education, pensions, and welfare programs.

The grim truth confronting the Keynesians and socialists right now, in both the United States and the EU, is that their economic model is unsustainable as things stand. Yet the very democratic politics on which we all pride ourselves make it exceptionally difficult to rationalize the welfare entitlements put in place in decades past and long since seen as the birth right of citizens of these societies. The core problem has been the piling up of entitlements based on pork-barrelling, budgetary irresponsibility, complacency and the relentless, self-interested lobbying of often unionized interest groups. The problems absolutely will not be solved merely by pouring more tax dollars into them. And in any case, there simply are no more tax dollars to be poured. The Western welfare state built on a Keynesian foundation is everywhere insolvent and needs to be fundamentally rethought and remodelled.

Seen in this context, the killing of Osama bin Laden is a sideshow. While no doubt a little more significant than the killing of Clyde Barrow and Bonnie Parker in May 1934 in the midst of the Great Depression and the international rise of fascism, it should be seen as that kind of event at the end of the day. What is far more important than celebrating the demise of one more murderous thug is seeing America's fiscal and political house put in order intelligently and democratically; and we are a long way from seeing that done right now. In fact, one has the impression that between them, Wall Street, the US Congress, the sprawling Washington bureaucracy and the even more sprawling, polyglot American public are entirely unable to agree on how to put things in good order and condition. In the circumstances, more than passing jubilation at the event in Abbottabad is an unwarranted distraction. What would be more salutary is dispassionate reflection on the seriousness of the challenges confronting democratic capitalism and the apparently intractable difficulties our institutions face in confronting them.

Note that, to this point, I have said nothing about international trade regimes, environmental challenges, weapons of mass destruction, the rise of China and its uncertain

ambitions or the looming problems of energy supply and resource security in a world striving relentlessly to emulate more than to transcend the American or European standard of living. These are all challenges that face the United States as much as anyone else and although Barack Obama has an unusual capacity to make a speech, there are few signs that he is proving able to get on top even of the fiscal challenges that confront his country, to say nothing of these other formidable challenges. Since I have several times invoked the Roman republic in these remarks this evening, let me echo a very famous Roman republican statesman, Marcus Porcius Cato the Elder (234-149 BCE), who after a visit to North Africa in 153 BCE, took to ending every speech he gave to the Roman Senate with the resounding refrain, “*Carthago delenda est*. (Carthage must be destroyed).” Our equivalent refrain should be much less simple and much less martial. It might take the form, “Sustainability must be assured!” And whereas Cato the Elder was renowned for his opposition to new ideas in Rome morals and society, we are in urgent need of new ideas and social innovation if the 21st century is to become one of human promise rather than of Western civilization and global order stumbling into disarray and even disaster.

About five years before the financial crisis broke upon the world, James MacDonald, a British investment banker of many years experience, took time out to write a very thoughtful book about public credit and democratic governance. It was called *A Free Nation Deep in Debt: The Financial Roots of Democracy* (Farrar, Strauss and Giroux, New York, 2003). In it, he argued that that what we might call democratic government – that is, government in which the citizens, even if a gender, property and race restricted minority of them – vote on public policy, instead of an autocrat or oligarchy monopolizing this prerogative – facilitated the rise of public credit, first in the classical Greek and Hellenistic world and then again in the Italian cities of the Renaissance; that this made possible the dynamic economies of the modern era; but that the virtuous relationship between democratic government and public credit has broken down due to the extravagant use of borrowing by democratic government to fund unsustainable welfare entitlements since the Great Depression and especially since the 1960s. The tax rate in the United States rose, he pointed out, from around 4% of GDP in the 1930s to almost 20% in the 1980s and the continuing ballooning in public expenditure since then has been funded by debt.

In reflecting on this state of affairs, five years before the global financial crisis, MacDonald expressed the sense that something had to give in the Western democracies because they had long since lost any disciplined sense of what was sustainable in fiscal policy. He quotes an eighteenth century political theorist, Alexander Tytler, as having written:

A democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largess from the public treasury. From that point on, the majority always votes for the candidates promising the most benefits from the public treasury with the result that a democracy always collapses over loose fiscal policy, always followed by a dictatorship.

While there does not seem to be an immediate prospect of the collapse of democratic government in the West in the wake of the 2008 crisis, it is salutary to think in these terms, because the problem did not start in the 2000s, it has not been remotely resolved as of 2011 and there a disturbing number of signs that, cognitively and fiscally, we are all rather like those thousands at Las Vegas in January 2007, having moved from the casino to the ballroom and hearing a kind of rant from the podium, but responding as if we are not actually hearing or heeding the words spoken, the warnings being given, the growing evidence that things are quite seriously and profoundly awry. We, of course, are not in Rome, but in the equivalent of Rhodes or Cos, island democracies on the fringes of the Greco-Roman world. Let no one think, however, that Rome's problems are not ours. We are deeply implicated and the problems are serious. The killing of Osama bin Laden has no significant bearing on them and they will not be resolved without quite fundamental rethinking of long standing assumptions about the roots and management of our well-being.

Let me end my rant from the podium at this point and invite you to respond not by talking around what I've said, not by silence, but with questions of all kinds, which I shall attempt to address to the best of my ability.