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OFF THE SHELF

When the Splurge Takes Its Toll

By STEPHEN KOTKIN

Correction Appended

ON the way up, financial toxic waste was sold as “a new paradigm.” Now, on the long way down, the response is “Help, the sky is falling!”

Two angry new books attempt to explain what happened. In “The Trillion Dollar Meltdown” (PublicAffairs, $22.95), Charles R. Morris offers a persuasive diagnosis of the long-building credit crash, with a regulatory prescription. In “Bad Money” (Viking, $25.95), Kevin Phillips decries the “debt-gorged and negligent financial sector” and its clout, reflected in bailouts.

Mr. Morris, a former banker and an especially graceful writer, recognizes the benefits of high finance. In his telling, American industry and post-World War II Keynesianism got their comeuppance in the 1970s. Paul Volcker at the Federal Reserve cleaned up the horrific mess — “one of the great episodes of American public service” — but in the view of Mr. Morris, this opened the way for a new excess: the market religion of Chicago School economics and the helium Fed of Alan Greenspan.

The scary trillion dollars of Mr. Morris’s title is his estimate for the great unwinding now just beginning. He calls out for a new Volcker to save us from the limbo suffered by post-bubble Japan, even as he suggests that the Fed lacks the power it once had (a point now being debated). Nor is he sure if only another 25-year cycle is ending, this one of deregulatory dogma, or if the United States is in relative global decline.

Mr. Morris accessibly explains Wall Street’s arcane instruments, and spikes his narrative with aphorisms. (“As a general rule, only the very smartest people can make truly catastrophic mistakes.”) He lays bare today’s mess by tracing the 1980s leveraged-buyout boom, precursor to the 2000s private-equity ball, as well as the “scams” of the savings-and-loan crisis and “the staggering fatuity of portfolio insurance.” This is a smart layperson’s guide.

Conservative policies, Mr. Morris writes, produced not just excess but a great market restructuring, while government can become bloated. Even so, he stumps for a return to what he calls high-quality government, which builds infrastructure and exercises “effective oversight over the finance industry.”

Events have rocketed most of Mr. Morris’s suggestions from nonstarter status and into the glare of suddenly worried lobbyists: for example, having loans to superleveraged parties carry penalty capital
charges, or moving now secretive trades in high-volume credit derivatives into public exchanges. On the
slog to regulatory revision much bruising politicking looms, but the current framework has become
indefensible.

Mr. Phillips, who worked for the Nixon administration and published “The Emerging Republican
Majority” back in 1969, presaged a rightward realignment around the South and the western Sun Belt. As
this conservative ascendancy wore on, however, he took to denouncing Wall Street, American oil gluttony,
Christian theocracy and the House of Bush, which he saw as all interlinked. In his new book, he writes that
maybe the end is nigh — not just for Republicanism, but for American predominance.

Nobody planned it, Mr. Phillips argues, but the financial sector has taken over, assuming top rank in the
economy at more than 20 percent of gross domestic product. (He adds that in 2004, financial services’
share of all corporate profits reached 44 percent, compared with 10 percent for manufacturing.) To his
eye, this was possible because debt — which he likens to crack cocaine — was turned into a profit machine.

The indignation runs deep: powerful interests elbow and shove to get the financial system they want. In
their minds, they help first-time home buyers realize their dreams and spread the risk by securitizing it
and releasing it to the marketplace. But in the process, they privatize profits while socializing costs, and
put all of us in jeopardy. The democratic political system, driven by money, colludes.

Mr. Phillips practices his own mild form of securitization, slicing and packaging ideas of his previous
works in this new product. And chunks are thrown in from Financial Times columnists, Austrian School
economists and the theory that global oil production has peaked. Putting energy profligacy on a par with
indebtedness, Mr. Phillips tries to bundle it all into a theory of history.

Changeovers in energy regimes, he asserts, induce shifts in dominant world powers. The Netherlands,
which so long ago mastered wind and water energy, yielded to Britain when coal rose to prominence. And
Britain was displaced by the United States with the rise of oil, he writes. But a separate argument blames
the absence of industrial policy. “Money is ‘bad,’ ” Mr. Phillips speculates, “when a leading world
economic power passing its zenith” indulges “in finance at the expense of harvesting, manufacturing, or
transporting things.”

Never mind that finance aided the rise of the 17th-century Netherlands and 18th-century Britain, or that
each is exceptionally well off today. Even though no new energy regime appears in the offing, Mr. Phillips
hints at the eclipse of America by “Asian state capitalism.” As the new joke goes, he writes, “Shanghai,
Dubai, Mumbai or goodbye.”

Of course, those are all financial centers. Competition from them, as well as from London, is a big reason
the design challenge for new regulation in the United States will be mighty. Another is that any American
regulatory framework would need to remain effective even if enforcement became lax.

Mr. Morris can berate Mr. Greenspan for having refused to exercise the Fed’s oversight over the mortgage
market, but his critique cannot eradicate the deep antiregulatory sentiment that pervades the corporate
culture and produces people like Mr. Greenspan in the first place.

In the end, Mr. Phillips and Mr. Morris agree on a great deal: after the gargantuan write-downs, foreclosure fights, possible punishments, rescues and regulatory overhaul, someone will still need to blow the whistle on America’s oil-and-debt toga party.

This article has been revised to reflect the following correction:

Correction: April 13, 2008
The Off the Shelf column last Sunday, a review of books about credit problems and the financial sector, rendered the name of the publisher incorrectly for one of the books, “The Trillion Dollar Meltdown.” It is PublicAffairs, not Public Affairs.