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Unfettered markets cause of U.S. economic chaos

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While it may seem surprising, the underlying cause of the cataclysmic financial and general economic instability now racking the United States is the decades-long unraveling of the ideology that saved the country the last time it confronted such trying conditions, the Great Depression of the 1930s.

In response, then President Franklin Roosevelt and his unusually innovative group of advisers created the New Deal, a comprehensive set of institutional and legitimating frameworks that alleviated much human misery, eventually pulled the United States out of the Depression, and created unparalleled prosperity that lasted for several decades.

The key and explicit assumption of the New Deal was that, while markets were certainly the central force behind economic growth, unregulated markets were a significant danger to not simply the "losers" but the health of the entire economic system.

As a result, there were strong and legitimate reasons for government to play an active role in setting the rules within which markets operated, and making sure those rules were vigorously enforced.

While this insight would hardly be shocking in Japan in the post-Meiji era (1868-1912), it was close to revolutionary in an America drenched in the myths of "rugged individualism."

The success of this approach was not simply domestic. Using the same sort of creative thinking, the United States constructed a system in which it served as the consumer/financier/investor of last resort for the unprecedentedly successful global economy that developed after the devastation of World War II —the most striking symbols of which were the Marshall Plan in Europe and the rapid reconstruction of Japan in Asia.

While there were stresses and strains throughout the 1950s and '60s, the first significant cracks came with the oil shocks of 1973 and the end of cheap oil.

This was followed by the watershed year 1979, which featured not only the second oil price shock but also the self-destructive Soviet invasion of Afghanistan, and, particularly upsetting for Americans, the Iranian Revolution, seizure of the U.S. Embassy, and the ensuing 444-day hostage crisis.

The response to these traumas—as well as the still undigested loss in Vietnam—was a reversion to the "rugged individualism" of the pre-New Deal era, symbolized and then strengthened by the election of Ronald Reagan as president in 1980.

For Reagan, government was not part of the solution to economic problems: Government was the problem.

And due to the seeming success of Reagan policies—and the evident lack of any clear Democratic alternative—the ideology of free markets once again became the dominant orthodoxy among all sectors of the U.S. elites.

The result was a progressive dismantling throughout the 1980s and '90s of the stringent rules within which U.S. corporations, including banking and finance, had successfully operated until then.

Even though this free market ideology was put forward most strenuously by Republicans, it was embraced almost as heartily by Democrats, especially those in Congress, who enthusiastically subscribed to what became known globally as "the Washington consensus."

Indeed, it was during the years under President Bill Clinton that the most significant legislative blow against the New Deal—one whose tragic consequences are only now being clearly seen, albeit not necessarily understood—was struck: The undoing of the Glass-Steagall Act in 1999.

Passed in 1933, Glass-Steagall delinked commercial and investment banking, whose intertwining had been a major reason for the conflicts of interest and outright fraud fueling the rampant speculation that caused both the 1929 stock market crash and the less-remembered banking collapse of early 1933.

In addition, it established the Federal Deposit Insurance Corporation to safeguard the integrity of de-

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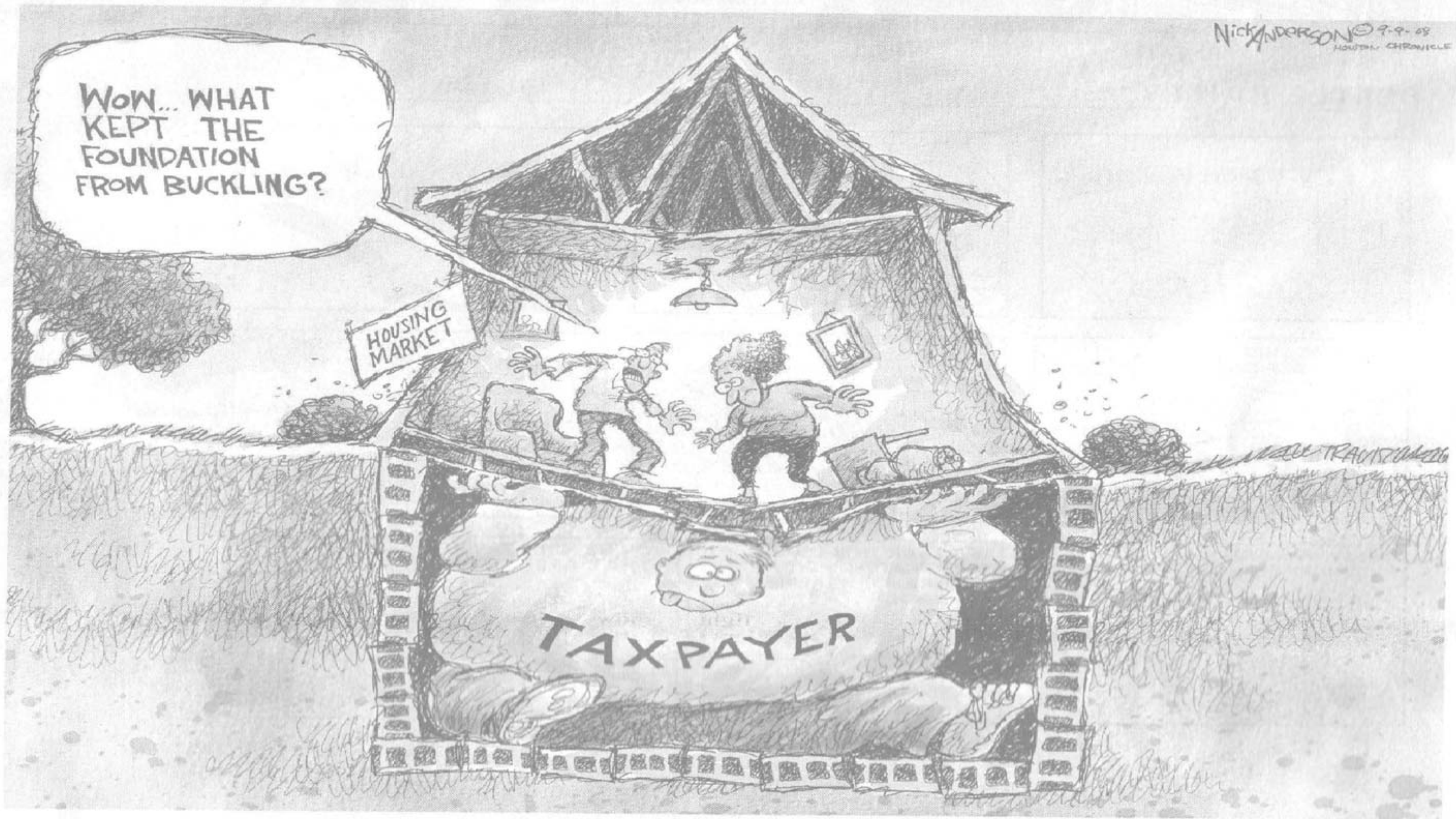

posits in commercial banks.

Glass-Steagall thus provided a safety net for depositors and clear rules for bankers.

The strong separation of commercial from investment banking—whose joining had proved so destructive in the 1920s and early '30s—was eliminated by the Gramm-Leach-Bliley Act, signed into law by Clinton in 1999.

It is precisely the resurgence of the ideology of free and unfettered markets—and the removal of the barriers between low-risk but stable commercial, and high-reward but uncertain investment, banking—that is responsible for the stunning recent events.

The government rescue of Bear Stearns Cos., the taxpayer-financed bailout of mortgage giants Fannie Mae and Freddie Mac, the bankruptcy of 150-year-plus-old Lehman Brothers Holdings Inc., the fire-sale of Wall Street stalwart Merrill Lynch & Co., the unprecedented federal takeover of insurance behemoth American International Group Inc., the possible implosion of the savings and loan titan Washington Mutual Inc., and yet unspecified and unknown debacles to come—all can be traced directly to deregulation and the free-market ideology that pushed so strongly for it.

Precisely because the problems cannot be solved by a quick policy fix since they lie at the much deeper level of ideology and strongly-held belief systems, the prospect for the United States is difficult indeed.

Put bluntly, there is no easy way out of this cascading series of disasters, not least because U.S. elites have been operating for decades under the same faulty set of assumptions that caused the crisis in the first place.

And as the wild swings in financial markets everywhere indicate, the central place of the United States in the global economy means there won't be any fast or simple solutions for the rest of the world either.