# U.S. crisis is intellectual, too

By David Caploe
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In market systems, the pursuit of self-interest is given. The key task in guiding such economies, therefore, is to insure the overall result maximizes the common good, and not intensify the Hobbesian "war of all against all."

While never easy, post-World War II history shows that can be accomplished—if approached with a strong commitment to balancing what Joseph Schumpeter called the "animal spirits" of capitalism with order and transparency.

In that context, the current financial and, increasingly, the economic crisis that began in the United States and now is spreading in various forms throughout the world represents a major intellectual failure among every major sector of the U.S. elite.

The problems began at the top, starting with the administration of former U.S. President Ronald Reagan and intensifying under President George W. Bush and Vice President Dick Cheney, who indulged nearly every maneuver the inventive high-tech genius of Wall Street devised.

Of many possible examples, perhaps the most significant was the decision of the U.S. Securities and Exchange Commission on April 28, 2004, to grant the insistent request of the major investment banks—none of whom today exists in the form they did then—to cut limits on the amount of money they had to keep in reserve to cushion any possible losses.

In addition, the SEC agreed to rely on the companies' own models for determining investment risk, in essence, as The New York Times recently put it, "outsourcing the job of monitoring risk to the banks themselves."

Among the disastrous results of this move was the creation of the now-multitrillion dollar "credit derivatives" market—the foundational element of the "shadow banking system" whose collapse is now wracking world bourses and economies.

While the financial giants showed brilliant ingenuity in maximizing "animal spirits," they failed dismally with the balance/order/transparency side of the equation—an omission shared by crucial overseers of the system such as former U.S. Federal Reserve Board Chairman Alan Greenspan, who remains a strong proponent of derivatives to this day, and current Fed chief Ben Bernanke and Henry Paulson at the Treasury Department.

Their striking intellectual deficiency was underscored when major players in this system began to fail at the very "game" for which they had so militantly lobbied: Bear Stearns, mortgage giants Fannie Mae and Freddie Mac—who had successfully pushed for similar "unshackling"—followed quickly by Lehman Brothers, Merrill Lynch and insurance behemoth AIG.

At no point did Paulson or Bernanke seem to realize the sudden collapse of longtime Wall Street titans represented not simply isolated cases of bad luck or management, but were, instead, the first cases of a systemic financial meltdown, threatening to cripple not just the global financial system, but the "real economy" underlying it.

Indeed, their proposed "solution," the so-called Paulson Plan, showed similar intellectual weakness when, despite all the melodrama of its rejection-then-passage by the U.S. Congress, global stock markets basically ignored it, continuing to fall, and the even more dangerous freeze in the credit and commercial paper markets only intensified. In this context, no less shocking was the discourse in Congress around the Paulson "plan": It was clear practically that no members had the slightest idea of the substance of what they were voting on, let alone whether their action would have any effect, positive or otherwise, at all.

To some, it seemed a classic case of "we need to do something—this is something—let's do this," an impression of intellectual emptiness underscored by Paulson's disturbing admission that, in the absence of Congress' OK, there was no Plan B. This glaring absence of intellectual resources was equally evident in the one place one might expect original analysis, if not creative solutions—academia.

Sadly, the input of conventional academic economists so far is as lacking as the political and policy chieftains whose inability to realize what was going on caused the contagion to flower and spread in the first place.

To be sure, some have analyzed significant aspects of the problem as it was developing, e.g., Nouriel Roubini, and begun to put forward components of a realistic solution, e.g., Robert Rubin and James Galbraith. Prestigious positions aside, their substantive analysis and proposals have been consistently marginalized and ridiculed by the academic economic establishment, and ignored almost completely by both general and business media.

That a mainstream media blatantly obsessed with celebrity culture, epitomized by Paris Hilton fascination, has been oblivious to economic issues is sad, albeit predictable. But the equal lack of serious analysis or constructive policy proposals from business media—which has reflected, rather than calmed, the fear gripping global share and credit markets—indicates yet another way the current crisis has been created and perpetuated by the intellectual poverty of public life in the United States.

The most constructive response to the chaos so far has come from the intelligently crafted, if-not-totally-perfect, British plan to recapitalize banks on terms advantageous to taxpayers and the treasury.

The world must hope the United States can recognize its intellectual inadequacy to date, and be willing to accept good ideas from wherever they emerge—if not, who knows if, when, how or where this frightening crisis will end.

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**Bliss**
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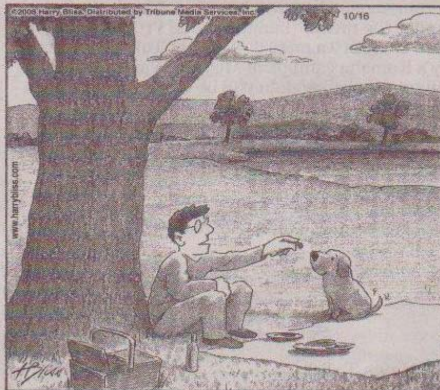


"Go ahead, it'll put fur on your chest."